Report of the Auditor General of Canada to the House of Commons

Fiscal Year Ended
31 March 1984

© Minister of Supply and Services Canada 1984

Available in Canada through

Authorized Bookstore Agents
and other bookstores

or by mail from

Canadian Government Publishing Centre
Supply and Services Canada
Ottawa, Canada K1A 0S9

Catalogue No. FA 1-1984E Canada: $5.55
ISBN 0-660-11733-9 Other Countries: $6.65

Price subject to change without notice
Copies françaises aussi disponibles

AUDITOR GENERAL OF CANADA VÉRIFICATEUR GÉNÉRAL DU CANADA

To The Honourable the Speaker of the House of Commons:

I have the honour to transmit herewith my Report to the House of Commons for the fiscal year ended 31 March 1984, to be laid before the House in accordance with the provisions of section 7(3) of the Auditor General Act, S.C. 1976-77, c. 34.

Kenneth M. Dye, F.C.A.
Auditor General of Canada

OTTAWA, 7 December 1984

8!

TABLE OF CONTENTS

Chapter — Page

Introduction

1. MATTERS OF SPECIAL IMPORTANCE AND INTEREST — 1-1

2. GENERAL SUMMARY - 1984 ANNUAL REPORT — 2-1

3. AUDIT NOTES — 3-1

GOVERNMENT-WIDE AUDITS AND OTHER STUDIES

4. REVIEW OF CASH MANAGEMENT — 4-1

5. INTERNAL AUDIT — 5-1

6. MANAGEMENT OF REAL PROPERTY — 6-1

7. MANAGEMENT OF TRAVEL — 7-1

8. MANAGEMENT OF JOB CLASSIFICATION — 8-1

AUDITS OF DEPARTMENTS AND AGENCIES

9. CANADIAN INTERNATIONAL DEVELOPMENT AGENCY — 9-1

10. NATIONAL ENERGY BOARD — 10-1

11. DEPARTMENT OF THE ENVIRONMENT — 11-1

12. DEPARTMENT OF NATIONAL DEFENCE — 12-1

13. DEPARTMENT OF PUBLIC WORKS — 13-1

14. SECRETARY OF STATE — 14-1

* * * *

A detailed table of contents precedes each chapter

Chapter		Page
15.	ORGANIZATION AND PROGRAMS OF THE OFFICE OF THE AUDITOR GENERAL	15-1

APPENDICES

Appendix		
A.	AUDITOR GENERAL ACT	A-1
B.	FINANCIAL ADMINISTRATION ACT - EXTRACTS FROM PART VIII	B-1
C.	REPORTS OF THE STANDING COMMITTEE ON PUBLIC ACCOUNTS TO THE HOUSE OF COMMONS	C-1

A detailed table of contents precedes each chapter

REPORT OF THE AUDITOR GENERAL

TO THE HOUSE OF COMMONS

FOR THE FISCAL YEAR ENDED 31 MARCH 1984

INTRODUCTION

The principal functions and responsibilities of the Auditor General of Canada are set out in the Auditor General Act, S.C. 1967-77, c. 34, which came into force 1 August 1977. My responsibilities in respect to those Crown corporations for which I have been appointed auditor are set out in sections 76 to 78 of the Financial Administration Act, R.S.C. 1970, c. F-10. The Auditor General Act is included as Appendix A to this Report, and the relevant sections of the Financial Administration Act appear as Appendix B.

In compliance with section 7 of the Auditor General Act, my Report for the fiscal year ended 31 March 1984 is presented here.

My examinations included general reviews of the accounting procedures and such tests of accounting records and other supporting evidence as were considered necessary to enable me to report as required by the Auditor General Act. My staff was generally provided with the information and explanations required. However, as I indicate in paragraphs 1.51 to 1.69 of my Report, I was denied access to essential information I deem necessary. Specifically, as of 31 October 1984, the Ministers of Energy, Mines and Resources and Finance and their Deputies have denied me access to information relating to the expenditure of up to $1.7 billion in public money from the Canadian Ownership Account to purchase Petrofina Canada Inc.; the Deputy Minister of the Department of National Revenue-Taxation has denied me access to information relating to certain income tax rulings involving foregone revenues estimated to be in the order of $200 million; the Vice-Chief of the Defence Staff of the Department of National Defence has denied me access to information relating to the expenditure of over $10 billion for the acquisition of equipment and the construction of facilities; and the Deputy Minister of the Department of Transport has indicated that the Department will not provide me with certain information relating to my audit of the Air Program. The officials of the Departments of Defence and Transport have informed my Office that they are acting on the instructions of the Clerk of the Privy Council.

The financial statements of the Government of Canada for the fiscal year ended 31 March 1984, which have been prepared by the Receiver General for Canada in accordance with the provisions of section 55 of the Financial Administration Act and appear in Volume I of the Public Accounts of Canada, have been examined by me as required by section 6 of the Auditor General Act. My opinion and observations on these statements are also in Volume I of the Public Accounts.

MATTERS OF SPECIAL IMPORTANCE AND INTEREST

MATTERS OF SPECIAL IMPORTANCE AND INTEREST

Table of Contents

	Paragraph	Page
The Numbers Have a Message	1.2	1-1
The Office of the Auditor General	1.15	1-3
Information Needed to Fulfil Audit Responsibilities	1.51	1-10
Crown Corporation Legislation Passed	1.70	1-13
The Financial Statements of the Government of Canada	1.96	1-18
Insufficient Information to Parliament	1.119	1-21
Productivity Problems	1.158	1-25

Exhibits

		Page
1.1	Comprehensive Auditing	1-7

1

MATTERS OF SPECIAL IMPORTANCE AND INTEREST

1.1 I report to Parliament, and I am aware that this 1984 Report will be read by many Members of Parliament who were elected for the first time in September. I have therefore chosen to direct this first chapter particularly to new MPs. I want to begin with some numbers from the Public Accounts and then go on to discuss the work of my Office.

The Numbers Have a Message

1.2 Parliament has instructed the Auditor General to report matters of significance. That mandate requires me to call attention to anything that I consider to be significant to Members of Parliament. As Parliament's auditor, when I examine the Financial Statements of Canada year by year, there are clearly matters of significance in those accounts that relate to trends in the numbers. And I know from the many comments made during the recent election that the numbers relating to deficit, revenue, expenditure, debt and cash flow are of immense interest and significance to all Members of Parliament.

1.3 I see it as one of my most important responsibilities to report to MPs significant changes and trends in these numbers. It is then for Government and Parliament to decide whether to initiate policies that will change the trend that the numbers show.

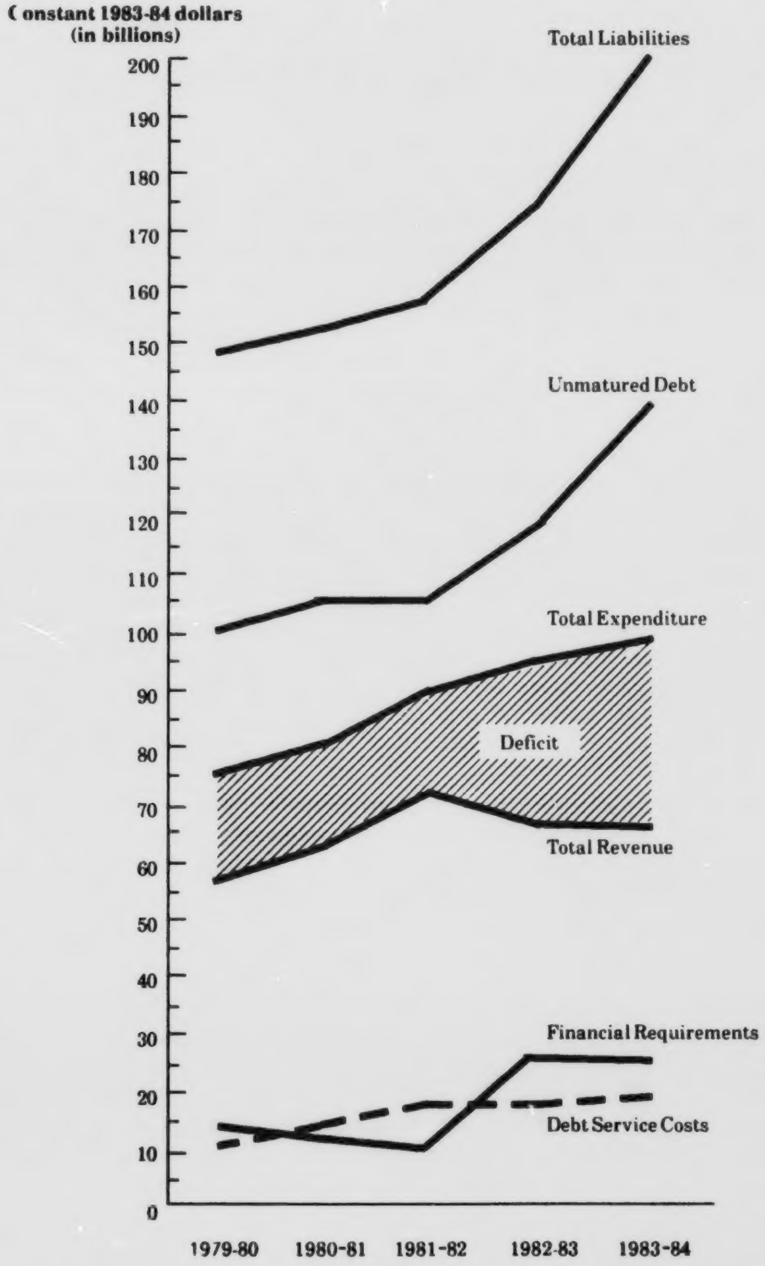
1.4 I am a bit like a diagnostician taking my part in performing an annual physical examination. I check the patient's weight and pulse and blood pressure. The information I have verified then goes forward to those who must make decisions – Government and Parliament.

1.5 The information is also sifted through by economists. Some economists picture Canada and its deficit as an individual who has become increasingly obese. They express concern that the economy, the financial heart of the nation, must pump more and more money into servicing the annual debt – the unproductive flab added year by year to an already overweight patient.

1.6 Other economists believe that the deficit is not excessive and that, in the perspective of the world economic scene, Canada is in reasonably good shape.

1.7 The fact that there is such disagreement is a further incentive for me to ensure that the financial information that MPs and economists receive sets out as informatively as possible the financial position of the Government. That is an issue to which I return later in this chapter.

1.8 Meanwhile, using such information as is available in the Public Accounts of the last five years converted to constant 1984 dollars, I have graphed the numbers that I believe MPs will find significant:



see notes on page 1–34 .

1.9 The changes in the size of the numbers are significant. It can be argued that the changes are short term. But nonetheless the numbers show that over the last two years revenue has moved downward at the same time that expenditure has continued climbing, producing a widening area of deficit. Liabilities, including unmatured debt, are rising rapidly with the result that debt service needs will almost certainly move upward in future years, and cash requirements will continue at a very high level.

1.10 The economists who believe the deficit is too large would say that, as with the overweight individual, an excess corpulence is producing stress throughout the system. But, again, others would argue that the deficit is not the cause of problems but is itself the product of underlying economic forces.

1.11 However, focusing only on the numbers themselves, what concerns me as an accountant who has dealt for many years with numbers and accounts and graphs of this kind, is the speed and momentum of recent trends. As I see it, there is a real danger of events moving so quickly as to overtake the decision making of Parliament.

1.12 Clearly, the size and nature of the deficit result, in large measure, from a variety of policies and programs requiring significant expenditures without sufficient revenues to cover those expenditures. And while I am aware that there are strong arguments that an economic policy that encourages the creation of such a deficit is the correct policy in difficult financial times, MPs will have to judge for themselves whether they wish Canada to continue to borrow in order to pay for the groceries.

1.13 My thrust in this message to MPs is that, besides the deficit, there are other very significant numbers revealed in the Public Accounts, and that I should be doing less than my duty as Auditor General if, in this annual check-up, I had not alerted MPs to the the trends and pace of change in those numbers.

1.14 My staff or myself stand ready at all times to meet with Members of Parliament who may wish to learn more about the numbers in the Financial Statements of Canada. They are important numbers, and I ask MPs to carefully consider them in the context of each Member's own economic viewpoint and political perspective.

The Office of the Auditor General

1.15 The position of the Auditor General rests on three principles. The first is that the Government of the day has an obligation to the people of Canada in regard to its use of public funds. It must ensure that funds are properly raised, protected from loss, expended only for the purposes approved by Parliament, and that value for money is obtained when that money is spent.

1.16 The second principle is that Members of Parliament have the responsibility to scrutinize the affairs of Government; to assist in that scrutiny, the Government must supply parliamentarians with complete and understandable information on how it has carried out its activities.

1.17 The third principle is that there must be a knowledgeable and impartial person who has the mandate to examine the information supplied by the Government to MPs, to make independent examinations of the departments, agencies and programs of the Government, and to report significant matters to MPs, so that they may fulfil their responsibility – rooted in history, tradition and law – of holding the Government accountable for its actions.

1.18 This independent person within our system is the Auditor General. The information he provides to Parliament is, primarily, contained in the annual Report. It has been said that MPs are elected to the House of Commons to serve their fellow Canadians. The Auditor General is, then, the servant of the servants of the people of Canada.

1.19 The activity of the Office of the Auditor General is governed by the Auditor General Act, 1977. In essence, the Act requires me first of all to fulfil what may be termed a traditional financial auditing role as the auditor of the accounts of Canada. But, as well, it requires me to call attention to anything that I consider to be of significance and of a nature that should be brought to the attention of the House of Commons. And, among other matters, the Auditor General must report "any cases in which he has observed that ...money has been expended other than for purposes for which it was appropriated by Parliament; money has been expended without due regard to economy or efficiency; or satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented."

1.20 The Act, therefore, requires me not only to verify financial information, but also to seek to give assurance to Members of Parliament that value for money has been achieved in the expenditure of public funds, to report instances where this has not been true and, finally, to inform MPs where the Government has not established the procedures to measure the effectiveness of its programs.

1.21 **Our work**. This is not the place to spell out in any detail how we go about our work. However, it may be helpful to the new MP for me to say something about the activity that lies behind this annual Report.

1.22 To fulfil my mandate, I am required as Parliament's auditor to examine the Public Accounts of Canada and to express an opinion as to whether they present information fairly in accordance with the stated accounting policies of the federal government and on a basis consistent with that of the preceding year, together with any reservations I may have.

1.23 This involves traditional 'attest' auditing of all government departments and agencies each year, and results in the "Opinion and Observations by the Auditor General on the Financial Statements of the Government of Canada", which appear in the annual Public Accounts.

1.24 In addition, I express a separate audit opinion on the financial statements of each of the Crown-owned corporations and other agencies for which I am named auditor.

1.25 There is a further aspect to this annual component of our work. It is very important that a parliamentary auditor be able to provide assurance to Members of Parliament that legislative authorities have been complied with and that public money has been spent for the purposes voted by Parliament. This extends the attest function to encompass what we refer to as 'authorities auditing' (see Exhibit 1.1). My auditors identify occasions where, for example, irregular payments have been made, power to expend funds has been exceeded, payments have been made in advance of need, authorities have not been complied with, and other similar matters. Where I have deemed these to be of significance and of a nature that they should be brought to the attention of the House of Commons, they are included in the annual Report.

1.26 Our auditing then moves on to encompass a broader survey of specific departments, agencies and programs. In the case of departments, this special examination is performed on a cyclical basis. We try to cover each major department at least once in every five years. The audit may involve a whole department or, as in the case of the Department of the Environment in this year's Report, specific programs within a department.

1.27 This examination represents a logical extension of the attest and authorities audit in order to determine whether value for money has been received for the public funds being spent.

1.28 I know that Members of the present House of Commons, recently elected in a time when the need for governments to examine the costs of their programs is of intense concern to all Canadians, have a particular interest in this value-for-money component of my mandate. So do I. I have constantly urged that those who have the responsibility of spending the taxpayers' dollars should bring the same care to that task as informed Canadians do in using their own personal funds.

1.29 I have this fond hope – I trust not a naive hope – that within the time I am Auditor General, all politicians and public servants will adopt that most common sense of principles in the expenditure of public money: they will spend it as wise and prudent individuals spend their own.

1.30 Value-for-money auditing has been steadily evolving through the past years and its importance is recognized internationally by governments and by the accounting community. Canada is an acknowledged world leader in the field.

1.31 In essence, it involves establishing reasonable criteria for the efficient and economic operation of a particular entity by evaluating the actual performance of the organization in terms of those criteria, then providing an opinion as to whether due regard for value for money has been demonstrated. And if not, why not. This kind of auditing requires specialized skills, and, in addition to accountants, my Office employs engineers, economists, statisticians, lawyers, mathematicians, computer scientists and actuaries together with specialists in management and effectiveness evaluation.

1.32 When an audit of a department encompasses all three of the attest, the authorities and the value-for-money components, we refer to it as a comprehensive audit (see Exhibit 1.1).

1.33 We also apply comprehensive auditing methods to our examinations of a number of government-wide activities. In this year's Report, these include a review of cash management, internal audit, management of real property, management of travel, and management of job classification.

1.34 More details as to how the work of the Office is carried out and the resources involved are in Chapter 15, Organization and Programs of the Office of the Auditor General.

1.35 **Reporting**. If all this work is to have value, it must result in reports that can be acted on. Throughout the auditing process, audit findings are discussed with the management of the entities being audited. At the conclusion of an audit, a management letter is issued consisting of a formal, detailed report to the management of the audited organization on my Office's findings, conclusions, recommendations and audit opinions.

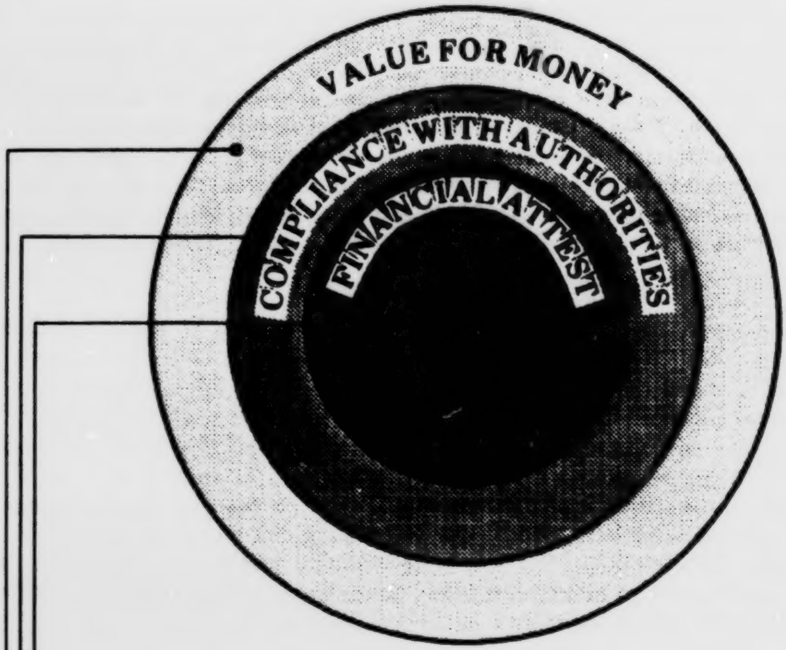
1.36 With my auditors and senior personnel, I then discuss those matters that I deem to be of significance and of a nature to be brought to the attention of the House of Commons and report them in the chapters of the annual Report.

1.37 This is a difficult task. As the Independent Committee for the Review of the Office of the Auditor General of Canada recognized in 1975:

> It will always be a matter of judgement for him (the Auditor General) to strike a balance between providing sufficient information to Members of Parliament so that they can fulfil their responsibilities as custodians of the public purse, while at the same time avoiding such a multitude of detail that it becomes confusing for them to identify priorities for further probing of past events.

Exhibit 1.1

COMPREHENSIVE AUDITING


VALUE FOR MONEY
COMPLIANCE WITH AUTHORITIES
FINANCIAL ATTEST

Assurances that financial statements are fairly presented

Assurances that legislative authorities have been complied with

Assurances that due regard for value for money has been demonstrated in the expenditure of funds

Financial attest + compliance with authorities + value for money = the comprehensive audit

1.38 I am aware that our annual Reports – albeit summaries of our audit findings – are long. One reason for this is that I require that our chapters be fair and objective. It would be easy enough for me to provide Parliament with a catalogue of 'horror stories', representing isolated incidents of errors and inefficiencies. However, that would neither be fair to the departments nor helpful to the Members of Parliament in their work. What, I hope, do prove helpful are examples of failures to achieve value for money that are clearly linked to a demonstrated need for greater care and control.

1.39 I can illustrate what I mean from this year's audit of the Department of National Defence (DND). There, readers of this Report will discover that some of the contractors' original cost estimates for spare parts for Canada's recently acquired CF-18 fighter aircraft proved wildly out of line. An initial estimate for an antenna assembly was $9. Its actual cost may prove to be over $2,000. A self-locking bolt, originally estimated at $2, may end up costing over $140.

1.40 I am quite aware that in reporting such figures, I am probably providing a newspaper with a headline. And that may be all to the good. It will help to focus the attention of Canadians and their representatives in Parliament on the significance of matters in this Report.

1.41 However, the purpose of our auditing is not to report a super-expensive antenna or bolt. Our purpose is to identify the underlying cause and tell the full story. Therefore, the report of our audit of DND goes on providing a description of the difficulties the Department encountered in attempting to structure an adequate pricing agreement, while ensuring a flow of essential spare parts to the Canadian Armed Forces.

1.42 We also report to Parliament that the Department recognized the problem and moved at the time to contain it to the best of its ability.

1.43 The obligation to be fair and objective goes further. I am required by my mandate to report things that have gone wrong. This can produce a false impression. An individual recently sent me this quotation by the American historian, Barbara Tuchman:

> Built into the very nature of recorded history is overload of the negative: the disproportionate survival of the bad side.... In history this is exactly the same as in the daily newspaper. The normal does not make news. History is made by the documents that survive, and these lean heavily on crisis and calamity, crime and misbehaviour, because such things are the subject matter of the documentary process.

1.44 I recognize that there is a similar problem with this document. The matters 'of significance and of a nature that should be brought to the attention of the House of Commons' tend, intrinsically, to be negative.

1.45 However, many of the activities of Government are well designed and work well. Throughout this Report there are references to activities of Government that my Office has looked at which are achieving the objectives Parliament intended for them and providing value for money to the taxpayers of Canada.

1.46 Since my appointment as Auditor General, I have recognized that the length and complexity of my annual Reports present problems for the reader. I have, this year, made a further attempt to alleviate these problems and to make my annual Report more readable. I have gathered the synopses – or summaries – from all our government-wide and departmental comprehensive audits and studies into Chapter 2. Chapter 3 contains audit notes resulting from our attest and authorities auditing in other departments and agencies. The MP, therefore, who reads these first three chapters will have a good understanding of the most significant findings of our auditing. However, to understand the context and implications of a particular issue the detailed audit chapters must be read.

1.47 Hand in hand with the length of my annual Report is the question of its timeliness.

1.48 The fiscal year on which I am only now reporting concluded eight months ago. It will be several more months before the Public Accounts Committee (PAC) will have completed its consideration of this Report. I am anxious to see the whole process speeded up.

1.49 Three years ago, and again last May, I shared my concerns about this with the PAC. As a result of that hearing, the Committee stated in its Fifth Report that it had considered

> the reporting practices of the Auditor General and, in particular, the timeliness of his annual Report to the House of Commons. Your Committee notes that, under the present Auditor General Act, the Auditor General normally may report only annually to the House of Commons. Your Committee favours the reporting of comprehensive and other audits on a completion-date basis. This will enable your Committee to deal with the Auditor General's findings in a timely manner and to exert its remedial influence as soon as possible after the audit is completed. The Auditor General endorses this approach because it provides for greater efficiency and flexibility in his reporting to Parliament.

The Committee went on to recommend that the necessary changes be made to the Auditor General Act to permit this more timely reporting.

1.50 I commend this proposed change toward more timely reporting for consideration and action by the new Parliament. I am convinced that it would greatly enhance the usefulness of the information that my Office provides to MPs.

8.

Information Needed to Fulfil Audit Responsibilities

1.51 Free access to all information needed to fulfil responsibilities is fundamental to auditing. This principle, as it applies to the Auditor General, is given statutory definition in the Auditor General Act. The opportunity to consider all relevant facts before forming and reporting my opinions is fundamental to the fulfilment of my statutory duties. In conducting their examinations, my staff must have access to all pertinent information and explanations.

1.52 Among the matters of special importance and interest that I have to report to Parliament, is that, on 5 July 1984, I instructed my solicitors to file a motion in the Federal Court of Canada. The court has been asked to direct the Minister of Finance, the Minister of Energy, Mines and Resources and their respective Deputy Ministers to provide me with all information pertaining to the acquisition of Petrofina Canada Inc. that they prepared, received or considered in the exercise of their statutory responsibilities, particularly those relating to the Canadian Ownership Account, one of the accounts of Canada.

1.53 In 1982 and 1983, I reported on the lack of evidence that due regard for economy had been exercised in expending $1.7 billion in public funds from the Canadian Ownership Account to acquire Petrofina Canada Inc.

1.54 Beginning in 1982, many discussions to obtain information about the acquisition were held with Petro-Canada, the Department of Energy, Mines and Resources, the Department of Finance and the external auditors of Petro-Canada. I was advised that assessing of oil companies to be acquired and negotiating of acquisition price were delegated by Cabinet to Petro-Canada but that the decision to purchase was retained by Ministers. I was also informed by the Chairman of the Board and Chief Executive Officer of Petro-Canada that both a pre-acquisition and a post-acquisition commercial evaluation were conducted, but that he would not give me access to the evaluations.

1.55 In March 1984, after two years of discussions, I still had not received the information I needed on the acquisition to fulfil my responsibilities to Parliament. After an extensive constitutional and legal review of the matter, I decided to invoke the access to information powers entrusted to me by Parliament in the Auditor General Act.

1.56 Since Petro-Canada had prepared commercial evaluations of the acquisition, I wrote pursuant to section 14(2) of the Auditor General Act to Petro-Canada on 9 March 1984 to request the evaluations and any other documents pertaining to the acquisition of Petrofina Canada Inc. that were presented to officials of the Government of Canada. On 10 April, I received a negative reply from Petro-Canada. On 16 April, as a matter of propriety and courtesy, I then wrote to the Cabinet pursuant to section 14(3) to advise it of Petro-Canada's failure to provide the required information and to give the Cabinet an opportunity to direct Petro-Canada to deliver the required information to me. By 25 May 1984, I had not received any acknowledgement of my 16 April 1984 letter. In the absence of any reply, I decided to invoke the full powers of the Auditor General Act. Pursuant to section 13(1) of the

Auditor General Act, I wrote to the Minister of Finance and the Minister of Energy, Mines and Resources to obtain the required information. These Ministers are responsible for approving the capital budget of Petro-Canada and are named in the Appropriation Acts as responsible for authorizing the expenditure of up to $1.7 billion to purchase Petrofina Canada Inc. I also wrote to the Deputy Ministers of these Departments, themselves members of the Board of Directors of Petro-Canada that approved Petro-Canada's recommendation to the Ministers to purchase Petrofina Canada Inc.

1.57 When I did not receive the required information from any of the parties, I informed each of them that I considered their lack of action to constitute a denial of my free access to information as provided for by the Auditor General Act. In view of this unprecedented denial by Ministers, I wrote on 25 June 1984 to the Prime Minister, the Right Honourable Pierre Elliot Trudeau, to bring to his immediate attention the failure of the Minister of Finance and the Minister of Energy, Mines and Resources and their Deputy Ministers and Petro-Canada to provide the required information.

1.58 On 26 June 1984, after over two months without a reply, I received Cabinet's decision by Order in Council declining to direct Petro-Canada to provide the required information.

1.59 On 29 June 1984, the Prime Minister replied indicating that he was in agreement with the actions of his Ministers and their Deputies.

1.60 During this exchange of views and correspondence, the core of the issue became increasingly clear. Notwithstanding the Auditor General Act, the Cabinet of the day appeared to consider the information that I required to be a Confidence of the Queen's Privy Council for Canada, to which it believed that I am not entitled. It also appeared to consider – again, notwithstanding the Auditor General Act – that it was beyond my authority to give an opinion to Parliament on whether the expenditure of $1.7 billion in taxpayers' funds to purchase Petrofina Canada Inc. was made with due regard for economy. I do not agree with the Government's position.

1.61 In connection with my audit of National Revenue - Taxation, I have begun to examine whether the Department applied prudent rules and procedures in issuing certain tax rulings. On 27 June 1984, I requested copies of certain income tax rulings and related information from National Revenue - Taxation. The Department has raised concerns about confidentiality. I have provided the Department with assurances in this regard. However, at the time of writing, I have not received the requested information. I estimate the tax revenues foregone related to certain rulings to be in the order of $200 million.

1.62 My auditors have also been denied necessary information to fulfil audit responsibilities in the Departments of National Defence and Transport. The Vice-Chief of the Defence Staff of the Department of National Defence informed my Office that the Department would not provide me with all the information I deemed necessary to enable me to give a complete opinion to Parliament on whether the Government had exercised due regard for economy in spending over $10 billion of taxpayers' money on 6 major equipment acquisitions - CF-18 fighter aircraft, Aurora long-range patrol aircraft, 2.5 ton trucks, general purpose armoured vehicles, Canadian Patrol Frigates, and the Destroyer Life Extension Program - and 12 construction projects. My auditors have been able to examine how the Department has administered the programs but not whether the acquisition of the equipment and the initiation of the construction projects were done with due regard to economy.

1.63 Similarly, the Deputy Minister of the Department of Transport has informed my auditors that the Department would not provide me with certain required information relating to the audit of the Air Program.

1.64 The officials of these two departments informed my Office that they had been told by the Clerk of the Privy Council that the information I require is a Confidence of the Queen's Privy Council for Canada and that I am not entitled to such information.

1.65 I strongly believe that the integrity and credibility of my Office and my ability to report to Parliament would be seriously imperilled if Cabinet is permitted to decide what information I will or will not be able to examine. Further, I have been advised by legal counsel that the Auditor General Act requires ministers and officials to provide me with information I deem necessary to fulfil audit responsibilities.

1.66 Because no further progress was possible in respect of Petrofina Canada Inc. and because access to information had been restricted in these other audit situations, I reached the conclusion that it was both necessary and desirable for the fulfilment of my responsibilities to Parliament to clarify the powers of the Auditor General Act by judicial interpretation of its provisions.

1.67 Between the dates of 5 July 1984, which marked the commencement of my action in the Federal Court, and 31 October 1984, the printing deadline for the Report, the lawyers in the Department of Justice have been waiting for instructions from the Government. At the time of this Report going to press, I have not yet received the information I require in order to fulfil my responsibilities to Parliament.

1.68 On 31 October 1984, the Minister of Energy, Mines and Resources announced that a private sector auditing firm is to conduct a study of the purchase of Petrofina Canada Inc. by Petro-Canada. I welcome this study as a step toward making Crown corporations more responsible to ministers.

1.69 However, this action by the Minister does not relieve me of my duty to Parliament to audit the expenditure of public money from the Canadian Ownership

Account. Furthermore, the action of the Minister neither addresses nor resolves the matter of my access to information that I require to fulfil my statutory responsibilities to Parliament. I have thus instructed my legal counsel to seek a court date to resolve this matter.

Crown Corporation Legislation Passed

1.70 In previous annual Reports I have addressed the theme of the accountability of Crown-owned corporations. My contention has been that when the Government achieves its policies through its departments and agencies, a framework for accountability is in place, but that when the Government chooses to fulfil its policies through Crown-owned corporations, the accountability framework has proved inadequate.

1.71 This, I have suggested, is of concern to parliamentarians for two primary reasons: first, Crown-owned corporations form a huge segment of Canada's total economic life; second – and this is integral to these reflections on the role of Members of Parliament in holding the Government accountable – the information about Crown-owned corporations that both the Government and Parliament might receive could be incomplete and less than timely.

1.72 I am therefore pleased that on 28 June 1984, Parliament passed Bill C-24, an Act to amend the Financial Administration Act in relation to Crown-owned corporations and to amend other related Acts. The new Act received Royal Assent on 29 June 1984 and came into force on 1 September 1984. I commend the Government for introducing the legislation and Parliament for reviewing, adopting and passing it. On a personal note, I was most pleased to be consulted by the Government prior to the introduction of the Bill, particularly in regard to its accountability provisions. I was further pleased and privileged to appear before the Miscellaneous Estimates Committee when, in April, it was considering the legislation.

1.73 Enactment of this legislation introduces the most comprehensive revision of the Crown corporation accountability régime in over 30 years. In doing so, the legislation addresses many of the concerns expressed during the past decade by the Public Accounts Committee, individual Members of Parliament, the Lambert Royal Commission on Financial Management and Accountability, government officials, my Office, and others. I am particularly pleased that, in essence, the new accounting and auditing provisions for federal Crown corporations and their wholly-owned subsidiaries correspond closely to those I have been recommending in my recent annual Reports.

1.74 No legislation is perfect. But I believe that the Financial Administration Act, as amended by Bill C-24, provides a more appropriate and comprehensive framework for the control, direction and accountability of Crown corporations. It achieves a balance between giving the corporations the flexibility and independence of action that they need while retaining the parliamentary oversight and government control appropriate for the public sector.

1.75 **Principles of the legislation**. At the tabling of Bill C-24, the then President of the Treasury Board, the Honourable Herb Gray, described the fundamental principles of the legislation in the following terms:

- Parliament would be required to approve the creation, financing and disposal of each parent corporation.
- Parliament would be informed of the objectives of Crown corporations as set out in their annual corporate plans and as approved by government.
- Parliament would have a systematic flow of timely, pertinent information to allow it to judge whether Crown corporations have met their stated objectives for each planning period.
- The Government would be responsible for the strategic and budget decisions of all parent Crown corporations and, through them, their wholly-owned subsidiaries, and for any directive the Government issues. These directives are to be tabled in Parliament.
- Crown corporations would be subject to a rigorous audit régime that not only meets but exceeds that normally applied in private sector corporations.
- The responsibilities of the boards of directors of all Crown corporations would be set out clearly.

1.76 In my view, these fundamental principles are sound. I also believe that the legislation as passed reflects these principles in large measure. I am particularly happy to see the emphasis on the fundamental role of Parliament.

1.77 However, I recognize that the implementation of the legislation in accordance with these principles will require the good will, dedicated effort and co-operation of numerous participants.

1.78 **The audit challenge**. My Office has a dual interest in Crown corporations.

1.79 First, as Parliament's auditor, I am interested in monitoring the implementation of the amended legislation. In the future, I would wish to be able to report that the accountability of Crown corporations to Government and Parliament has improved as a result of the amendments to the Financial Administration Act. Further, I would like to be able to report that the audit and special examination provisions of the Crown corporation legislation have been fully implemented, are consistently understood and that, as a result, auditors can provide the assurances required by the legislation.

1.80 Second, as the auditor of a large number of Crown corporations, I face the tasks of introducing the required changes in the annual audit of these corporations and conducting a number of special examinations. The legislation introduces some new concepts, including annual audits of quantitative performance information and periodic examinations of systems and practices. As such, it poses significant challenges to my Office and to my private sector colleagues. Some of the key provisions relating to audits and special examinations are described briefly below.

1.81 **Charge to the board and management.** The boards of directors and management of Crown corporations are charged with responsibility for keeping books of account and maintaining systems and practices that provide reasonable assurance that assets are safeguarded and controlled, transactions comply with stated authorities, resources are managed with economy and efficiency and operations are carried out effectively. Management and directors are also charged with assuring that internal audits are conducted on those issues.

1.82 **Audit of financial statements**. The amended legislation requires an annual auditor's report to be prepared, expressing the auditor's opinion on whether:

(i) the financial statements are presented fairly in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year;

(ii) such quantitative information respecting the performance of the corporation as is required to be audited is accurate in all material respects and was prepared on a basis consistent with that of the preceding year; and

(iii) the transactions that have come to the auditor's notice in the course of the audit were in accordance with the new Part XII of the Financial Administration Act, the relevant regulations, the charter and by-laws of the corporation and any directive given to the corporation.

In addition, the auditor will be able to call to the attention of Parliament any other matter falling within the scope of the audit which, in his or her opinion, is of concern to Parliament.

1.83 **Special examination**. The legislation requires each corporation to have a special examination carried out at least once every five years. The special examination will be designed to determine if, during the period under examination, financial and management control and information systems and management practices were maintained in a manner that provided reasonable assurance that:

- assets were safeguarded and controlled;
- financial, human and physical resources were managed economically and efficiently; and
- operations were carried out effectively.

In my view, this special examination requirement corresponds very closely to the value-for-money component of the comprehensive audits that my Office has been conducting for many years in departments and agencies and in some Crown corporations as part of the "Laboratory Group" experiment established by the Office in 1979, or at the specific request of corporate management or the responsible Minister.

1.84 **Treasury Board quarterly report**. The President of the Treasury Board will now be required to table quarterly reports in the House of Commons and the Senate, indicating whether any annual reports and summaries of corporate plans and budgets required to be laid before the House or the Senate during a particular quarter were, in fact, tabled on time. Under the legislation, I am required to attest to the accuracy of the information in these quarterly reports in my annual Report to Parliament. I intend to begin this reporting in 1985.

1.85 **Interpreting and implementing the audit provisions of the new legislation**. As my Office, together with private sector firms, undertakes the substantial tasks of introducing required changes to the annual audit and starting a series of special examinations, we will need to draw on all the expertise and experience that we have acquired over the years and seek all the counsel that can be made available to us. I believe that my Office has a particular obligation to provide leadership in these new areas and that the experience gained in conducting comprehensive audits of Crown corporations in recent years will be particularly valuable in this respect.

1.86 Interpretation and implementation of audit and examination provisions will involve many participants. These include central agencies of government, Crown corporations, the firms and professionals providing auditing and special examination services, the Canadian Institute of Chartered Accountants and the Canadian Comprehensive Auditing Foundation.

1.87 As Parliament's auditor, my own commitment is to develop the kind of consensus among the key participants that will enable the spirit and intent of the new legislation to be fully carried through. Parliament has provided us with the machinery. It is incumbent on my Office, working with the country's auditing profession and on behalf of all Canadians, to make the machinery work.

1.88 My Office and others providing audit or special examination services must reach a consensus on the definitions of terms in the new legislation with respect to annual audits and special examinations. We must develop and/or revise methodology to suit the requirements of the new legislation as well as contribute to developing and using high standards of practice. In each of these processes, we must include the views and perspectives of all the participants, and especially the Crown corporations and the central agencies. Considerable work in all these areas is already under way.

1.89 For example, we have been working closely with government officials and our private sector colleagues on questions of mutual interest. We have reviewed the implications of the new legislation with a number of corporations and, in some, have started to develop plans or to carry out specific projects to implement the new requirements. We are in the process of revising our Office's *Comprehensive Auditing Manual* to reflect the new legislation. And we have already developed a variety of briefings, training and materials to help our staff to adapt to the changes.

1.90 **Future directions**. Although this new legislation has addressed the accountability, control and direction of wholly-owned parent corporations and their wholly-owned subsidiaries, a significant number of corporations with a degree of public ownership is excluded. In particular, the legislation does not deal with the large number of corporations where ownership is shared with the private sector and/or provincial governments. These corporations include parent corporations such as the Canada Development Corporation, Telesat Canada and the Canarctic Shipping Company Limited, as well as partially-owned subsidiaries.

1.91 The legislation, therefore, does not address (nor was it intended to address) the second recommendation of my 1982 study of Crown corporation accountability: that Parliament should give attention to issues surrounding control and accountability of those mixed enterprises and other entities and associates in which the Crown is a shareholder. An appropriate accountability framework for shared enterprise corporations and a variety of other entities without share capital remains to be considered by Parliament.

1.92 My Office has initiated a study on shared enterprise corporations and their accountability to Parliament and Government. I expect to report the first results from this work in my next annual Report.

1.93 It is important to note that implementing the new provisions will have the effect of increasing the resources required by my Office. Not only will I be the auditor of more corporations than in the past, but there will also be an increase in the work carried out by my Office by virtue of the new requirements for special examinations and the audit of quantitative performance information in corporations, as well as the audit of Treasury Board's quarterly reports to Parliament.

1.94 **Parliament's responsibility.** I have emphasized the number and variety of players who must be involved in ensuring that this new legislation achieves its intended purpose. The role of MPs is crucial in making the legislation work. Parliament will be receiving quantities of new information in regard to the creation, financing and annual plans of Crown corporations, as well as important information resulting from the audits and special examinations. Members of Parliament have important and immediate decisions to make on the ways in which – within an already busy schedule – they deal with this information.

1.95 For if they do not do so, the intent of the new legislation will surely fail.

The Financial Statements of the Government of Canada

1.96 At the beginning of this chapter, I had something to say to Members of Parliament about trends and changes in Canada's economic situation as revealed in the Public Accounts of Canada.

1.97 Closely related to that issue is my continuing concern about the quality of the financial information MPs receive.

1.98 Improving the relevance and usefulness of the information provided in the Audited Financial Statements of the Government of Canada is a matter of urgency for Members of Parliament and all Canadians.

1.99 New Members of Parliament may wish to know that I addressed this issue in some detail in last year's annual Report. The thrust of my words was that the financial statements should, as informatively as possible, set out the operational results and financial position of the Government.

1.100 The issue remains of great significance to all those who must make decisions that are based on the information contained in the financial statements. MPs are, of course, among the most important of these users. For instance, the financial statements include a measurement of our country's deficit.

1.101 Economists, politicians, academics, business people, bankers continue to discuss the implications of the deficit.

1.102 While I will not enter into that discussion, my task very certainly is to ensure that those participating in it - especially parliamentarians - have the benefit of the most fair and complete financial information available, to the extent that it is drawn from the Government's financial statements.

1.103 For a number of years, I have concluded that the presentation of those financial statements is neither fair nor complete.

1.104 For example, in my Opinion on the statements, I have called attention to fragmented reporting of government activities, overvalued assets, and unrecorded liabilities. These issues have a significant effect on the information presented in the financial statements, including the deficit.

1.105 The basic reason for my Opinion being qualified is that the financial statements do not present information in accordance with its essential nature or substance. As a consequence, readers are not told what actually happened.

1.106 The principle of reporting information in accordance with its essential nature is commonly referred to by accountants as reporting the "substance" of activities rather that just their legal "form". Reporting on the basis of "substance" is widely accepted in the accounting profession. Within the past year, the concept of 'substance over form' has been endorsed by both the House of Commons Standing Committee on Public Accounts and the Standing Senate Committee on National Finance.

1.107 But the Government has not yet accepted this principle for its financial reporting. Distortions resulting from this failure are so pervasive that it is not possible to get a fair picture of even such basic measures of the Government's activity as its revenues and expenditures. I am continuing to review the incidence of such distortions to determine more fully the nature and extent of the problem.

1.108 For example, as we point out in Chapter 13 of this Report, the Government may obtain the use of major capital assets either through outright purchase or through long-term lease. Leasing may be tantamount to buying if substantially all benefits and risks of ownership are transferred to the Government. In such circumstances, sound accounting would require that the transaction be disclosed for what it really is - a purchase. The Government doesn't do this. Annual payments are all that are disclosed. As a consequence, neither the cost of the asset nor the future funding requirement is reported in the Estimates or in the Public Accounts. I return to this issue in my discussion of what I perceive as an overall insufficiency of information for Parliament.

1.109 Also, the Government's Child Tax Credit program requires those entitled to benefits to make claim for payment on their income tax returns. Benefit payments are treated as if they were a refund of income taxes paid, and thus they are not visible in either the Estimates or in the Public Accounts. As a consequence, Child Tax Credit expenditures of $2.1 billion made during 1983-84 are not shown as expenditure even though, in substance, that's what they really are.

1.110 Accounting and reporting standards with sufficient rigour to resolve such issues, as well as those raised in my Opinion, are urgently required. The Standing Committee on Public Accounts has recommended that the government resolve the differences with my Office, and the Office of the Comptroller General is studying how to do so.

1.111 But, in the long run, much more is needed. Little research has been done to identify who is trying to understand what about the federal government, and why. Without a thorough knowledge of financial statements users and their information needs, improvements in financial reporting will be patchwork at best.

1.112 The Canadian Institute of Chartered Accountants (CICA), through its Public Sector Accounting and Auditing Committee, is vigorously pursuing the longer-term goal of establishing accounting and reporting standards that will be generally accepted by federal and provincial governments and their auditors.

1.113 But accounting research takes time, and the process of obtaining federal-provincial consensus is also time consuming and delicate. Clearly, the CICA cannot, and indeed should not be expected to, go it alone. Support and encouragement are needed from those most affected.

1.114 In view of my concerns with financial reporting practices of the federal government, I have launched a Federal Government Reporting Study in which the United States General Accounting Office is participating. The approach we are taking in the Study is to identify user needs for government financial information. Among those using the information are, of course, parliamentarians, and our Study will be specifically examining their needs. From this identification of needs, we will be attempting to identify what information can be provided in the summary statements to satisfy those needs.

1.115 Such criteria will greatly assist me in making reasoned judgements each year on whether the Government's financial statements present information fairly. In addition, the criteria will help me in advising Parliament on proposals for change being developed by the Office of the Comptroller General and should make a significant contribution to the ongoing work of the CICA.

1.116 Members of Parliament will be aware that this kind of problem is not confined to Canada. An informational inadequacy in regard to the accounts and statements of many countries haunts the international financial community, and the debt crisis intensifies the problem and the need for a solution.

1.117 I hope that our own Study, together with the other initiatives being taken in Canada, will be of assistance to other countries.

1.118 I am pleased to report that, in October, I had several discussions with the President of the Treasury Board who informed me that he is anxious to improve the summary statements as soon as possible. This year, because of time constraints in finalizing the Public Accounts, improvements have been limited to note disclosure and the recording of additional allowances in respect of certain liabilities and assets. Next year, I expect that the summary statements will be further revised, at least for those issues that can be analysed and resolved in the relatively short term. Other issues, such as fixed assets and tax expenditures, will require longer-term research on which to base changes.

Insufficient Information for Parliament

1.119 In both the matter of an improved accountability régime for Crown-owned corporations and in my continuing concern about what I perceive to be the inadequacies in the Financial Statements of the Government of Canada, my primary concern is that Parliament must be receiving prompt and pertinent information.

1.120 Only with such information can MPs fulfil their own decision-making and accountability responsibilities.

1.121 I therefore draw the attention of parliamentarians to several instances where I believe the information they are receiving is inadequate.

1.122 **Lease-purchases**. I have already referred to the use by the Department of Public Works (DPW) of lease-purchase arrangements as these affect – or more accurately, fail to affect – the Estimates or the Public Accounts. However, this use of lease-purchase has broader implications. Over the last several years, DPW has been acquiring buildings through this method which involves the Department in making monthly payments to developers by way of a lease. But these payments are not based on fair market rentals; instead, they are calculated to amortize the construction and financial costs quoted by the developer. An option for eventual purchase is usually included, and the option price is such that there is little doubt that the Crown will eventually exercise its option and take over the legal ownership of the buildings.

1.123 The total principal and interest payments required to finance the buildings – amounting to $1.9 billion, of which $1.6 billion was outstanding at 31 March 1984 – represent indirect borrowing through private developers that has not been disclosed to Parliament and very certainly has not been approved by Parliament.

1.124 In addition, because the monthly payments are shown as rental, the true cost of what is, in fact, the acquisition of capital assets has not been adequately disclosed. So Parliament has been left in the dark in regard to these substantial expenditures.

1.125 This whole matter is explored in detail in Chapter 13 of this Report.

1.126 **CF-18s**. Another example of the scrutiny of Parliament being by-passed is reported in this year's comprehensive audit of the Department of National Defence. It involves the CF-18 fighter planes.

1.127 When the cost of bringing these planes into service escalated, the Department approved covering some of the items normally classed as capital costs by charging them to operations and maintenance and deferring others. But neither Treasury Board nor

Parliament has been made specifically aware of these out-of-project costs which may amount to some $250 million for all the planes.

1.128 Similarly, with Cabinet approval, the Department has deferred procurement of some of the weapons, munitions and attrition aircraft and is employing funds that would have been so used for additional projects associated with the acquisition of the CF-18s. Once again, these costs, which will amount to $2.29 billion, have not yet been reported to Treasury Board and Parliament as part of the total cost of bringing the CF-18 into service.

1.129 I am not questioning these policy decision changes by Cabinet and the Department. What concerns me, and what I believe will concern Members of Parliament, is that MPs are not receiving full and timely information on these matters.

1.130 Canadians elect Members to Parliament in order that they may scrutinize the activities of Government and hold it accountable. They cannot do so if they are misinformed – or not informed at all – about certain of those activities. When such failures occur, the purpose of Parliament is eroded.

1.131 **Tax expenditures: revenues foregone.** I draw the attention of Members of Parliament to another area in which I believe they are receiving insufficient information, an area which is becoming of increasing concern to me as Parliament's auditor. It involves the use of so-called tax expenditures.

1.132 Expressed simply, Government implements its policies which require expenditure by two methods. The first is by a direct expenditure. This involves the use of actual funds. Parliament's auditor can follow the trail of those funds, ensure that they have been properly spent and provide parliamentarians with any information they should have.

1.133 However, Government has a second means of pursuing its fiscal policies. It can provide selective tax reductions to groups or individuals. These incentives allow the money that would have otherwise been received by the Government as taxes to be directed by the taxpayers who take advantage of these incentives toward activities which help to achieve government goals. These incentives are commonly referred to as tax expenditures.

1.134 I am not criticising the use of tax expenditures as such. Indeed, they have proved a useful instrument. For example, society has an interest in ensuring that all Canadians should, on their retirement, have access to sufficient funds to allow them to live in dignity. For those who are not covered by a pension plan, a registered retirement savings plan allows them to set aside earnings which are thus exempted from income tax in the current year. This exemption involves a tax expenditure by Government; in my personal view, it is a very appropriate one.

1.135 However, the use of tax expenditures is not without problems. To begin, it is important to recognize their massive impact. For every $100 that the Government spends directly, it may well be 'spending' an additional $30 to $50 by way of tax expenditures.

1.136 When Members of Parliament consider and vote on a direct expenditure, they can have a clear idea of the amounts committed. However, where a tax expenditure is involved, the issue becomes far less precise. The sums involved will depend on the extent to which individuals or groups respond to the incentive. By their very nature, the use of tax expenditures involves guesswork. Where direct expenditure is involved, full information is provided to parliamentarians in the Estimates. With tax expenditures, the information contained in the budget documents is deficient.

1.137 That the Government can really only guess how many individuals or groups will take advantage of these incentives is well illustrated by the scientific research tax credit program discussed in detail in Chapter 3 of this Report.

1.138 The implementation of the program has a number of disquieting features, not least that its cost, originally estimated in the information provided to Parliament at $100 million, will significantly exceed that amount.

1.139 A major focus of this Office and of Parliament has been on ensuring due regard for value for money in the programs of government. In terms of direct expenditures, mechanisms have been established to measure economy, efficiency and effectiveness and to report on these matters to Parliament. However, nothing like the same attention has been given to ensuring due regard for value for money where policies are implemented through tax expenditures.

1.140 Again, in terms of authorities auditing, it is exceptionally difficult to monitor whether the intentions of Parliament have been complied with in the operation and function of tax incentives.

1.141 These problems in achieving an acceptable level of accountability in regard to tax expenditures parallel in many ways what I have written in previous years about Crown-owned corporations. Like Crown corporations, tax expenditures have become part of the Canadian scene. But also like Crown corporations - before Bill C-24 - they represent a massive element in the public economy that is escaping the proper scrutiny of Parliament.

1.142 Tax expenditures are a huge hidden budget in the financial affairs of Canada.

1.143 I attempt an analogy. At the end of the last century, many scientists and educators believed that they were close to discovering how the human mind works, and how civilization and culture had shaped that mind to be more rational and self-disciplined.

1.144 Then Sigmund Freud and his disciples told us that there is a whole dimension of mind that remained unexplored - the subconscious. This subconscious or hidden mind, they said, is largely uncontrolled and unpredictable and yet has an enormous impact on the way a person behaves.

1.145 A similar problem faces parliamentarians in regard to tax expenditures. MPs have increasingly brought their scrutiny to bear on the direct expenditures of Government and have made it more accountable. But all the while, beneath the surface of any accountability régime, programs fuelled by tax expenditures have expanded, their real costs unquantified, their total effect a mystery. And these tax expenditures have an enormous impact on our nation's economy.

1.146 Within my Office, I have established an audit project to examine the complex accountability and compliance issues that grow out of the use of tax expenditures. Meanwhile, I suggest to Members of Parliament that they would do well to focus their own attention on the matter.

1.147 **Effectiveness**. I have a final subject of concern in regard to information I believe parliamentarians should be receiving. Raising the issue allows me to say one more thing to the newly-elected MP about the work of my Office.

1.148 I have already referred to the value-for-money component of our auditing. It is generally agreed that achieving due regard for value for money in any program involves three elements: economy, efficiency, and effectiveness. These are often referred to as the three Es.

1.149 My mandate requires me to examine the first two Es directly including bringing to the attention of the House of Commons any cases I have observed where money has been expended without due regard to economy or efficiency.

1.150 However, as the framers of the 1977 Auditor General Act recognized, the examination of effectiveness is more complicated and may involve a discussion of issues of policy.

1.151 Therefore, the 1977 Act stopped short of requiring this Office to measure effectiveness. Instead, it instructs the Auditor General to bring to the attention of the House of Commons any cases in which he has observed that "satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented".

1.152 In 1977, the Government adopted as policy the requirement that all departments and agencies establish procedures to measure the effectiveness of their programs. In 1978, the Office of the Comptroller General was established and given responsibility for implementing program evaluation throughout government.

1.153 In 1982-83, my Office undertook a government-wide study of program evaluation. We reported our observations and recommendations in last year's annual Report.

1.154 We expressed the view that Part III of the Estimates should incorporate the findings of evaluation studies that are pertinent to program performance and resource management. We further recommended that the Government should follow through on its commitment to grant timely access by Members of Parliament to the effectiveness and evaluation reports by departments and agencies.

1.155 At a May 1984 meeting of the Public Accounts Committee, the acting Comptroller General re-affirmed that the findings of evaluation on the results and performance of programs should be conveniently accessible to Parliament.

1.156 I believe that the issue remains an important one for Members of Parliament. The electorate of Canada is demanding value for money in carrying out the programs of government. The three Es are crucial to achieving value for money. For the reasons I have stated here, that final E – effectiveness – is very much in the hands of parliamentarians.

1.157 Therefore, I urge MPs to ensure that all relevant information from program effectiveness reports is available to them.

Productivity Problems

1.158 As I wrote at the start, I see this chapter of my Report this year as something of an opportunity to speak directly and especially to newly elected Members of Parliament.

1.159 It may, therefore, be useful information to the new MP that my 1983 annual Report contained a study titled Constraints to Productive Management in the Public Service.

1.160 The rationale for the study was – and I quote from its opening paragraph – that:

> There seem to be characteristics in the public service environment that make it difficult for managers to focus on productive management; that is to say, to concentrate on economy, efficiency and effectiveness and ensure that satisfactory results are achieved at reasonable cost.

1.161 Our study explored a number of these underlying constraints to productivity.

1.162 It is not my purpose here to re-visit that study. However, it may be of interest that it has received wide circulation and much favourable comment. Both from within our own country and internationally, I have had an overwhelmingly positive response. This response has come from the academic community, from private sector business persons and, most significantly, from public servants.

1.163 As a result of this interest, discussion and feedback, I am more than ever convinced that achieving a high performance public service rests on two things.

1.164 First, the various financial and other reporting systems within departments and agencies must be appropriate and be working well.

1.165 Second, the environments in which people work within each department must be designed to encourage and reward individual actions that lead to greater productivity.

1.166 A number of productivity problems associated with the systems of government have been addressed. However, problems associated with constraints to productivity-oriented individual actions have been addressed scarcely if at all. There is substantial evidence in this year's Report that these kinds of problems persist.

1.167 **Real property**. They permeate, for example, the management of real property, an area where we conducted a government-wide audit this year (it is reported in Chapter 6).

1.168 The lack of concern with economy and efficiency revealed by the audit takes a number of forms: failure to manage real property in a way that recognizes its value; failure to comply with policies; failure to install and use effective monitoring and control systems.

1.169 But the crux of the matter is that there is a lack of a sense of accountability for the full costs of holding and using real property. The responsibility for controlling the costs of real property in government is so fragmented that there are few incentives to achieve productivity.

1.170 **Travel**. Chapter 7 reports on the management of travel in five departments. It provides vivid examples of the kind of problem that concerns me.

1.171 We found that there was insufficient challenge by managers in the public service when those accountable to them were planning to travel. The result is that arrangements and costs are largely determined by the traveller with little incentive to travel economically. Nor are data being assembled on alternatives to travel, such as the use of reduced airfares and teleconferencing.

1.172 When taxpaying Canadians accuse those in government of not treating their dollars with sufficient care and frugality, these are the sorts of things they have in mind.

1.173 **Banking practices**. This seeming lack of concern can extend to significant financial transactions. Chapter 4, our review of cash management, provides two illustrations.

1.174 For many years, an arrangement has been in place whereby Canada's financial institutions provide banking services to the federal government without receiving direct compensation. However, the financial institutions have the interest-free use of certain government cash balances.

1.175 It sounds like a neat arrangement. However, its cost was not being calculated or monitored by the Government. So the Government did not know whether it was receiving banking services at a reasonable cost. My auditors estimated that over the last five years the cost to the Government has been about $348 million. In our opinion, that cost could have been reduced by up to $261 million during that period alone.

1.176 Again, current deposit and payment practices, including a variety of significant delays, are estimated to cost the Government approximately $43 million annually in lost interest.

1.177 I draw attention to these particular examples because they vividly illustrate the kinds of problems that trouble me.

1.178 We live in an age of consumer consciousness. Our newspapers regularly carry articles advising consumers of alternative banking services available to them. Canadians make their choice of a financial institution based on convenience, on the appropriateness of the services offered and, not least, on what it all costs. Today's banks, trust companies and credit unions have responded to this trend in their marketplace. They have become increasingly competitive, and Canadians have become knowledgeable and careful in the financial choices they make.

1.179 However, Canadians are also taxpayers and see a substantial portion of their income drawn away from them in order to finance government programs. No one enjoys paying taxes, but we understand the reason for them.

1.180 But the individual Canadian has learned to employ the retained portion to achieve maximum value for money. And that individual Canadian is increasingly demanding that the portion appropriated by Government should also achieve maximum value for money. If frugal consumers can insist on the most economical banking arrangements appropriate to their needs, then they can surely expect that their Government does the same; even in the very complex banking arrangements where the foregone revenue is not visible.

1.181 Indeed they have the right to ask Government, and their MPs, why the public sector seems not to have responded to today's belt-tightening demands, or to have reviewed or monitored its ongoing hidden costs in order to achieve the best value for money for the taxpayer.

1.182 That failure to respond troubles me. I offer a further illustration of my concern.

1.183 **Job classification**. Chapter 8 of this Report examines the management of job classification in a number of departments. Having observed that any degree of over-classification adds to the costs of government, our audit goes on to say that in a well balanced job classification system the inevitable upward pressures for higher classifications are counterbalanced by other forces in an organization. For example, in private sector profit-oriented companies, one powerful counter-incentive is an awareness that excessive salary costs can destroy the company's viability. The public sector does not possess a comparable incentive nor do current mechanisms foster a sense of accountability for the impact on productivity of job classification decisions.

1.184 However, as our 1983 study on constraints to productivity demonstrated, this kind of situation cannot be rectified by attempting to adapt private sector practices to the government environment. Rather, imaginative and creative new approaches to achieving improved productivity in the public sector environment must be developed and tested. I come back to this point before I conclude.

1.185 Meanwhile, this year's annual Report reveals further evidence that managers in the public service are not encouraged to act so as to achieve improved productivity.

1.186 **Translation services.** An example emerges from our audit of the Department of the Secretary of State (Chapter 14). It involves translation, a key activity of the federal government.

1.187 Our audit reveals that while annual production benchmarks were established as long ago as 1979, they are perceived and applied so differently within the Translation Bureau that the amount of translation required of translators at the same level varies considerably. The result is a continuing under-productivity.

1.188 **Revenue dependency**. Both Chapter 13, which reports our audit of the Department of Public Works (DPW), and our examination of the management of Real Property raise an issue that, I believe, should be of concern to MPs. This is the question of revenue dependency. Should DPW continue to provide departments with the accommodation and realty services they need at no charge to them, as is generally now the case? Or should the departments be charged for rent and services at realistic market rates?

1.189 This issue has been under discussion for over 25 years. In our 1978 annual Report, this Office recommended phasing in revenue dependency. In January 1981, the Cabinet approved in principle a proposal for revenue dependency by DPW. However, systems and policies are still being developed and implementation is not scheduled before the 1986-87 fiscal year.

1.190 My intuition is that, until government managers are directly accountable in their own budgets for the economical and efficient use of accommodation, there is little incentive to make the most cost-effective use of space. Revenue dependency would also require those who provide accommodation and related services to have a full knowledge of the true cost. They could also make a direct comparison of their performance with that of the private sector.

1.191 I am also profoundly troubled that, after a quarter century and many millions of dollars, a workable system for accommodation revenue dependency has still to be attained. As a minimum, an acceptable cost accounting system should have been in place before now.

1.192 **Year-end spending**. There is another subject which may well relate to the question of negative incentives in the public sector. This is the much-discussed matter of year-end spending.

1.193 While the private sector rewards a manager who spends less than is in the budget, the public service has traditionally tended to penalize the deputy minister who lapses funds.

1.194 The question has therefore been raised as to whether this results in any abuse by way of excessive spending by departments and agencies immediately prior to the close of the fiscal year.

1.195 As part of the cash management review, my Office examined the levels of year-end spending. We uncovered a number of examples of purchases and payments in advance of need. However, these examples did not necessarily indicate widespread abuse and waste.

1.196 We also found a number of situations that could have an impact on the levels of year-end expenditures, such as suppliers increasing prices early in the government's new fiscal year. Because of these price increases, acquisition in advance of plan and actual need could, in fact, result in savings to the government. We did note, however, that one of the reasons for increased spending at year-end continues to be the matter of avoiding the lapsing of funds.

1.197 Given the many and varied situations affecting year-end expenditures, I have decided that a separate government-wide study is required to determine conclusively whether there are widespread and significant abuses resulting from the acceleration of spending at year-end. The results of this study will be included in my 1985 annual Report.

1.198 **An example affecting the private sector.** A further disturbing aspect of the malaise that detracts from improved productivity involves a public program affecting the private sector. The case emerges from our audit of the National Energy Board. The section in Chapter 10 that particularly troubles me is titled Encouraging Economy and Efficiency in Regulated Companies.

1.199 The observation that most concerns me involves the toll-setting procedures of the Board for pipeline companies that transmit oil and gas across provincial boundaries. The Board encourages pipeline companies to be as efficient as they should be if they were subject to the competitive discipline of the marketplace. There is, in fact, only limited incentive for such regulated industries to control their operating costs because these costs can be recovered dollar for dollar in the tolls.

1.200 Not only may individual consumers be charged more to heat their homes than they should be but, more important in these economic times, Canada's hard-pressed industries may be paying too high a cost for their energy needs.

1.201 In all this enumeration of concerns – and the careful reader will find many further examples throughout this Report – I remind Members of Parliament, to whom these words are addressed, that my purpose is not to provide a list of 'horror-stories'.

1.202 **Many things work well.** I also reiterate that, by its nature, the Auditor General's Report leans to focusing on the negative. But despite that necessary emphasis on reporting imperfections, again and again throughout this annual Report there is a continuing catalogue of governmental activities that are working well; very often, very well. Also, my auditors report example upon example where corrective action has been taken as a result of this Office's recommendations and on the basis of internal audit and other departmental reports.

1.203 As Parliament's auditor, I am far from being discouraged. But I come back to my thrust that there needs to be increased attention given to improving productivity in the public service.

1.204 I was pleased by the positive reaction to last year's study on constraints to productive management, particularly by the reaction within the public service. Many public service executives have contacted me to request further information on the study to help them develop new approaches to improving productivity in their operations.

1.205 Yet, in spite of the interest and enthusiasm of many managers about the study, it is not clear that there is a serious effort under way to implement its major suggestions.

1.206 I was pleased when Treasury Board announced a program which included suggestions made in our study. But at the time of writing this, there does not seem to be a strong, visible effort under way by Treasury Board to review the impact of constraints and disincentives on productive management. Nor do there seem to be many experiments going on to help establish how the level of productivity in the public service can be improved.

1.207 Productivity improvement is not something that occurs spontaneously. It requires leadership. It requires a constant, deliberate effort by management, Government and Parliament over a prolonged period of time. We are still far from having established an environment in which managers are recognized and rewarded for managing productively, one which inspires rather than inhibits those who would place a high priority on productivity improvement.

1.208 I have become even more convinced over the past year that significant productivity improvements are unlikely to occur unless someone has clear responsibility for reviewing constraints in government and for assisting departments in their efforts to improve productivity. This, together with a clear political will to support productive management, is vital for improvement.

1.209 My Office will be placing more emphasis on the efficiency aspects of public programs. As part of that increased emphasis, we will be examining the many factors that limit or discourage productive management. We shall also be monitoring the efforts of government to improve productivity in the public service.

1.210 To balance the reporting of negative findings, I am instructing my auditors to report cases where they find operations that are running well. This will provide parliamentarians, the government and public servants with examples of the kind of excellence we are all seeking.

1.211 Indeed, even in the examples of productivity problems that I have used in this section to illustrate my concerns, some approaches being taken by government to solve those problems are reported in the corresponding chapters.

1.212 For instance, in the matter of departmental managers lacking informative data on how travel funds were being spent, my auditors identified one section of one department where they found that useful information was being gathered on the reasons why staff was travelling, together with an analysis of the costs. This information is now being made available to managers to help them plan and monitor travel.

1.213 As to that need for managers to be more aware of the costs of organizational changes that involve re-classification decisions, our study tells of the way in which one provincial government dealt with the problem.

1.214 **Toward improved productivity.** Finally, in these reflections on the persistence of productivity problems in the activities of government, I return to the overall recommendations contained in our study of this matter in last year's Report.

1.215 These included the need to increase incentives, reduce disincentives, and clarify managerial accountability for improved productivity; the need to give more attention to training and developing managers who can deploy their people most cost-effectively; and the need for the Government to take some initiatives to test out ways of increasing productivity.

1.216 However, because the overall purpose of my words this year has been specifically to convey a message to newly elected Members of Parliament, I draw to their attention what was, I believe, the most important observation that my Office made in the 1983 productivity study:

> Many of the factors that affect productive management are rooted in the nature of the political process and in the legislation governing financial administration and public service employment. Even though public service managers could make some progress on their own to improve productive management, it is unlikely that major changes could be made without the active support of Cabinet, the Government and Parliament.
>
> We suggest that, if Government wants to improve value for money in the public service, it should make it a key priority by demonstrating a strong interest in productive management.

I am extending the thinking behind that observation to the whole of this year's Report.

1.217 I believe that the chapters of this Report are, if at times hard-hitting, balanced, fair and constructive. They contain information that is important to the Government in pursuing its policy initiatives, and information that is vital to Members of Parliament in fulfilling their task of holding the Government accountable for those activities.

1.218 But the information contained here is only valuable to the extent it is followed up and acted on. Our observations and recommendations are greatly strengthened when those elected by the people give a clear signal that they believe those observations and recommendations are important.

1.219 A new Parliament has the opportunity of moving in new directions. I am making the following suggestions that I believe would assist MPs in using the information contained in this Report to achieve greater economy, efficiency and effectiveness in spending public money.

1.220 First, I would like to see the greatest importance possible given to the work of the Public Accounts Committee (PAC). That Committee's effectiveness depends on all its members being knowledgeable about accountability issues and good management practices.

1.221 Second, when the PAC issues its own reports, I would like to see time given by the full House of Commons to debating and discussing them.

1.222 Third, I would like to see the other committees of the House giving attention to the specific chapters of this Report that are relevant to their concerns. I believe it would be particularly helpful for the members of those committees to be knowledgeable about the results of our audits before they discuss the Estimates for the departments which are their special interest. This would help to complete the circle of accountability, allowing MPs to hold departments fully answerable for their expenditures.

1.223 Fourth, I urge MPs to ensure that all relevant information from program evaluation reports is available to them.

1.224 Finally, I remind the Government and the House of Commons that if in future years they wish to have the information revealed by our audits on a more timely basis, the solution is in their hands: the passage of legislation that instructs, or permits, the Auditor General to submit to Parliament reports of individual audits when they are completed.

1.225 Meanwhile, I am confident that all MPs and all Canadians will find matters of importance and interest throughout this year's Report.

The values in the chart on page 1-2 have been derived from the Audited Financial Statements of the Government of Canada adjusted to increase their comprehensiveness and comparability by

(1) giving retrospective application to the 1983-84 change in accounting policies described in Note 2 to the Financial Statements;

(2) reducing gross reported revenues and expenditures by the amount of internal transactions inappropriately included in those figures;

(3) consolidating transactions respecting the Unemployment Insurance Account and Canadian Ownership Account;

(4) Grossing up Oil Export Charges remitted to the provinces;

(5) treating the Post Office as being consistently outside the Government Reporting Entity; and

(6) restating 1982-83 and prior values in 1983-84 dollars based on an index derived from the quarterly implicit gross national product deflator.

GENERAL SUMMARY - 1984 ANNUAL REPORT

GENERAL SUMMARY - 1984 ANNUAL REPORT

Table of Contents

	Paragraph	Page
Introduction	2.1	2–1
Government-wide Audits		
Chapter 4 - Review of Cash Management	2.2	2–3
Chapter 5 - Internal Audit	2.14	2–5
Chapter 6 - Management of Real Property	2.18	2–6
Chapter 7 - Management of Travel	2.37	2–9
Chapter 8 - Management of Job Classification	2.45	2–11
Departmental and Agency Audits		
Chapter 9 - Canadian International Development Agency	2.58	2–14
Chapter 10 - National Energy Board	2.75	2–17
Chapter 11 - Department of the Environment	2.88	2–19
Chapter 12 - Department of National Defence	2.93	2–20
Chapter 13 - Department of Public Works	2.105	2–23
Chapter 14 - Secretary of State	2.128	2–26

2

GENERAL SUMMARY – 1984 ANNUAL REPORT

Introduction

2.1 This chapter contains a synopsis of each government-wide and departmental and agency audit chapter in the 1984 annual Report of the Auditor General to the House of Commons. The synopses are set out in the order in which the audit chapters appear in the Report:

Government-wide Audits

Chapter 4 - Review of Cash Management

Chapter 5 - Internal Audit

Chapter 6 - Management of Real Property

Chapter 7 - Management of Travel

Chapter 8 - Management of Job Classification

Departmental and Agency Audits

Chapter 9 - Canadian International Development Agency

Chapter 10 - National Energy Board

Chapter 11 - Department of the Environment

Chapter 12 - Department of National Defence

Chapter 13 - Department of Public Works

Chapter 14 - Secretary of State

Detailed audit findings, observations and recommendations are set out in the individual chapters.

CHAPTER 4 - REVIEW OF CASH MANAGEMENT

Scope of the Review

2.2 For purposes of our review, we defined cash as being those moneys flowing into, out of and within the Consolidated Revenue Fund, the government's bank account. This money amounts to $500 billion annually. We have defined cash management as those activities relating to billing, collecting and depositing money owed to the government, the payment of moneys and the use of government cash balances.

2.3 Cash management in the federal government involves a number of central agencies as well as individual departments and agencies. The central agencies are the Department of Finance, Treasury Board Secretariat, the Office of the Comptroller General, the Receiver General and the Bank of Canada.

2.4 We examined the way the government manages the cash management function, the cost of existing banking arrangements with the financial institutions, and the receipt and deposit of funds to and payments out of the Consolidated Revenue Fund. We conducted only a limited review of billing and collection practices, since a detailed examination of these areas will be included in future comprehensive audits of major revenue-producing departments. We also reviewed the public debt and the foreign exchange stabilization operations in order to understand their relationship to cash management. We did not review cash management operations in Crown corporations. However, we did examine the timing of payments to these organizations. We reviewed Bank of Canada operations only to the extent they related directly to its role as the government's banker.

2.5 Our audit covered certain areas previously examined by this Office and by the Lambert Royal Commission on Financial Management and Accountability.

Roles, Responsibilities and Relationships

2.6 Although each of the central agencies plays a role in cash management, no single agency has clearly defined responsibility for all aspects of cash management operations. There is a lack of overall co-ordination of efforts among the central agencies to improve cash management practices and arrangements, and there is a need to clarify their roles, responsibilities and relationships.

2.7 Cash management is a decentralized activity with policy and guidance roles shared among the several central agencies. The roles and responsibilities of the individual departments and agencies for cash management also need to be clearly defined. In our opinion, the problems identified in Chapter 4 are related primarily to the lack of clarity of these roles, responsibilities and relationships.

Current Banking Arrangements

2.8 Current banking arrangements with the financial institutions have been in place since 1959. The government does not calculate the cost to it of the services received from the financial institutions. Therefore, the government has not determined whether it is receiving these services at an economical cost.

2.9 In this respect, the government has not shown due regard for economy in terms of its banking arrangements. For example, in the five years since 1979, we have estimated that the cost to the government of its current arrangements with the financial institutions has amounted to about $348 million. This cost represents lost interest on government cash balances on deposit with the financial institutions. Based on our analyses, we believe that these costs could have been reduced for this five-year period alone by up to $261 million, or an average of $52 million a year. We did not attempt to calculate potential cost savings prior to 1979.

2.10 In our opinion, if the government had been calculating and monitoring these costs, it could have attempted much sooner to modify the arrangements, and substantial cost savings could have been realized. The current renegotiation with the financial institutions of existing banking arrangements should provide the government with an opportunity to obtain its banking services at a lower cost.

Deposit and Payment Practices

2.11 In addition to the interest loss noted earlier, current deposit and payment practices are costing the government approximately $43 million annually in lost interest. This is due largely to delays in processing deposits through the banking system and to payments made to suppliers earlier than standard commercial practice.

2.12 Most departments do not measure the time between receiving money and depositing it in the bank. Therefore, we were unable to calculate the costs associated with money received in departments but not deposited promptly in the bank. We believe these costs could be substantial, perhaps in the millions of dollars.

Payments in Advance of Need - Crown Corporations

2.13 We continue to be concerned about payments being made in advance of need to Crown corporations. The controls over the timing of payments to Crown corporations are inadequate. We have been unable to quantify the net cost to the government of making these advance payments because we did not have access to Crown corporation cash flow forecasts and other supporting information. A study is currently being conducted by the Office of the Comptroller General to determine if the system used for Canada Post, which eliminates payments in advance of need, is applicable to other Crown corporations. Eliminating such payments would result in substantial interest savings to the government.

CHAPTER 5 - INTERNAL AUDIT

Progress Made

2.14 Since our last government-wide review of internal audit in 1978, the government has made significant progress in establishing the internal audit function in departments and agencies. Treasury Board, through the Office of the Comptroller General, has issued standards for internal audit, provided direction and leadership to the internal audit community, and monitored the performance of departmental audit groups. Most departments now have an audit policy that provides for broad scope integrated audits, an established audit committee and assured access to the deputy head. They have made progress in establishing the processes for planning, carrying out, reporting and following up audit work.

2.15 Revised standards for internal audit have changed the nature, scope, purpose and importance of internal auditing. To achieve its full potential as an effective management tool, internal audit now has to place significantly more emphasis on controls to eliminate waste and inefficiency and on constructive services to assist management in achieving its goals.

Enhancing Internal Audit

2.16 Although significant progress has been made, several changes would enhance internal audit results and provide greater benefits from the resources used by internal audit. Most internal audit groups need to:

- place more emphasis on analysing potential audit areas to ensure that audit resources are applied to the areas of greatest risk and potential benefit to the department;

- increase efforts to assess the adequacy of controls to improve productivity and reduce waste;

- ensure that audit reports highlight significant findings, are issued on a timely basis, and provide managers with better information on the implications of findings and on the benefits to be achieved from implementing the audit recommendations;

- periodically assess their own activities to determine their contribution to the department and adjust their audit approach, based on the "lessons learned" from such reviews.

2.17 Internal audit has not yet reached its full potential for providing independent assurance to the deputy head on the adequacy of departmental systems or for making recommendations which have significant demonstrable benefits for departmental operations. However, with the strong support from deputy heads that is essential, and with continuing direction from the Office of the Comptroller General, internal audit should become an increasingly valuable management tool.

CHAPTER 6 - MANAGEMENT OF REAL PROPERTY

2.18 The federal government is the largest single landholder in Canada. Its departments and agencies hold about 20 million hectares of land and 62,700 buildings. Territorial lands not set aside for program purposes are not included in these holdings. The total holdings of Crown-owned corporations are not known. However, the value of the real property portfolio of departments and agencies, as estimated by the Treasury Board Secretariat, is probably in the range of $40 billion to $60 billion.

2.19 Annual capital expenditures by federal departments and agencies for purchasing and constructing or renovating land and buildings are about $671 million. Reported expenditures for rent, grants in lieu of taxes, and purchased material and services for operations and maintenance account for another $1 billion per year.

2.20 The full cost of holding and using real property, however, is higher than these expenditures. It includes, for example, salaries and wages of public servants who are involved in the management of real property, as well as depreciation and interest on the acquisition cost. In addition, there may be the cost of foregoing opportunities to develop or use properties to their full potential. These additional costs are not known with precision, but they are probably significantly greater than the known annual expenditures.

2.21 The government has carried out a number of studies of various aspects of its management of real property in the last 25 years. In 1962, the Royal Commission on Government Organization examined the acquisition, use and disposal of real property. This was followed by a joint Treasury Board Secretariat/Department of Public Works task force in 1970 that considered the possibility of managing real property through a Crown corporation. In 1975, a Privy Council Office/Treasury Board Secretariat/Department of Public Works task force examined the potential for cost recovery and revenue dependency in the management of real property. In 1978, the Standing Senate Committee on National Finance studied the provisions of accommodation by DPW and, in 1979, the Royal Commission on Financial Management and Accountability examined accountability in this area. Additionally, between 1976 and 1984, our Office conducted audits of office accommodation, planning capital acquisition projects, and energy conservation, as well as two comprehensive audits of DPW.

2.22 The most significant effect of these studies has been the evolution of a Treasury Board control framework that includes a comprehensive administrative policy for the management of real property. Federal departments and agencies are subject to this policy in their management of real property, but Crown corporations generally are not.

2.23 We examined departmental and agency management of approximately 130 properties. In addition to the acquisition and use of these assets, we also examined the context within which the management of real property takes place, including redeveloping or disposing of it.

2.24 The Treasury Board's policy directives and guidelines for the management of real property are generally adequate. Departments are responsible for developing and implementing control procedures to ensure adherence to the administrative policies. Our audit, and a recent review by the Treasury Board Secretariat of internal audit findings in 13 departments, concluded that compliance with these policies and procedures is not adequate. The Office of the Comptroller General, which is responsible for providing standards for departmental internal audit units in this area, is currently drafting a guide for auditing real property management.

2.25 The Office of the Comptroller General has published general definitions of economy and efficiency in its Standards for Internal Audit which provide guidance to departmental internal auditors. If these definitions were applied to the management of real property, all costs would have to be considered to address adequately the economy with which it is acquired and the efficiency with which it is used. It is necessary to address both as first steps in ensuring, as required by government policy, that the efficient provision of government services is effectively combined with the achievement of the wider social, economic and environmental objectives.

2.26 Financial administrative processes are primarily directed toward staying within appropriations rather than concern for the lowest cost to government. At times, this orientation may result in departments deferring development, renovation, disposal and sometimes maintenance of properties, even when deferral means foregoing benefits and incurring higher future costs.

2.27 The Treasury Board Secretariat has published a "Control Framework" for administrative policy that defines responsibilities of the Treasury Board Secretariat, the Office of the Comptroller General, and departments. The recent publication by Treasury Board, "Principles for the Management of the Public Service of Canada", provides some further clarification on the personal responsibility of managers for economy and efficiency in managing resources. However, departments generally have not fully implemented the controls required by the Control Framework. Hence, the procedures for holding managers accountable are still weak.

Real Property is Not Managed in a Way that Recognizes its Value

2.28 The detailed findings of this audit (see Chapter 6) contain numerous examples of lack of due regard for economy and efficiency. Most of these examples reflect a failure to comply with government policies. The extent of the failure to comply means that the government has little control over the management of this large asset. In addition, Parliament has insufficient information in respect to lease-purchases and implicit subsidies to Crown corporations. These concerns are based on the following findings.

2.29 Departments have not developed and implemented adequate procedures to ensure compliance with administrative policy directives and guidelines on the management of real property.

2.30 Departments frequently make inefficient use of the real property they occupy. For example, in the case of office accommodation, the occupants of the buildings examined in our sample occupied about 56,000 square metres of office space (about 13 per cent of their total space) in excess of their authority. The annual rental value of this excess space is about $9 million. The Department of Public Works estimates that, government-wide, the amount of excess office space is between 152,000 and 305,000 square metres. The Department estimates that this space has an annual cost of approximately $120 per square metre.

2.31 Departments frequently make inefficient use of the real property they hold. For example, Block 56 in Vancouver, acquired for about $3.3 million in 1972 and appraised at nearly $17 million in 1983, earns $12,000 a year as a parking lot. A project to develop the block was halted in 1978 by the Minister of Public Works because of the Government's austerity measures.

2.32 Some of the acquisition of real property is at higher cost than necessary. The government has carried out a number of leasing transactions without due regard to economy and proper authority. In Chapter 13, we report that the additional costs to the Crown from 12 leasing transactions we reviewed as part of the comprehensive audit of Public Works will amount to $63 million over the term of the leases, partly because of departmental failure to comply with the policy directives and guidelines on leasing real property.

2.33 The lease-purchase method of acquiring real property is usually more costly than Crown-financed acquisitions. This is because private developers usually must pay interest rates which are approximately 2 percentage points higher than the Crown would pay if it had financed these acquisitions through the Minister of Finance. In Chapter 13, we report that four major lease-purchase arrangements we reviewed as part of the comprehensive audit of the Department of Public Works will result in excess interest costs to the Crown of $86 million, $14.9 million on a present-value basis, over the 35-year term of the arrangements. In the Department's opinion, some of the excess cost can be offset by the potential benefit of having the developer assume risks during construction (delivery on time and within budget) as compared to Crown-construct (financed) projects.

2.34 The full cost and future funding requirements arising from the acquisition of real properties through lease-purchases are not being disclosed to Parliament. As discussed in Chapter 13, the growing use of lease-purchase as an acquisition method means that the acquisition costs of these properties are not identified in the Estimates as capital expenditures. Rather, annual expenditures under these arrangements are included in operations and maintenance budgets. The Department of Public Works states that its current practices conform to prescribed government accounting practices and that future Main Estimates (Part III) will fully display all construction and financing costs associated with lease-purchase projects.

2.35 **Development, construction, renovation, disposal and sometimes cyclical maintenance are deferred without adequate assessment, even when that deferral means foregoing benefits to the Crown and incurring higher future costs.** For example, approval to renovate the Block 15 complex in Vancouver and the Dominion Public Building in Toronto was not given until 1984, even though both were known to need renovation for 10 years or more. In the case of the Dominion Public Building, the annual rental value of the space held vacant because of the delay in renovations is about $850,000. The property at 3220 Dufferin Street in Toronto, which was acquired in 1971 for a letter processing plant, has not yet been developed. In 1979, the Post Office advised Public Works that it no longer needed the property.

2.36 **The use of real property can result in a subsidy to a Crown corporation that may not be identified and may not be disclosed to Parliament.** For example, in the case of the airfield at Canadian Forces Base Toronto, the provision of flying rights to the Crown-owned deHavilland Aircraft of Canada Limited from 1952 to 1982 at no cost was, in effect, a hidden subsidy. The continuing provision of these rights, on an operating cost recovery basis since 1982 when DND's need for an airfield ceased, represents a continuing subsidy of about $7 million per year, $5 million of which – the imputed interest cost on the value of the airfield – is, in effect, paid by the Department of Finance as part of public debt charges. The other $2 million is paid by the Department of Public Works as grants in lieu of taxes. We found no evidence that departments had considered the full costs of the support to deHavilland. In addition, the program objectives of the Departments of Finance and Public Works do not provide for subsidies to the aircraft industry, nor do those of the Department of National Defence. We are concerned that Parliament is not being adequately informed of the costs of such contributions and that ministers may not be adequately informed of the full costs of their decisions.

CHAPTER 7 - MANAGEMENT OF TRAVEL

2.37 Travel is an essential and integral component of government program delivery and management. Without travel, departments and agencies would not be able to carry out many tasks essential to government programs, such as health and safety inspections and on-site management of remote sites and international projects. Approximately 8 per cent of the stated expense for government travel is related to transportation of veterans, native people and other non-government employees in connection with various program activities.

Increased Travel Expenditures

2.38 Departments and agencies reported travel expenditures of $567 million in 1983-84, an increase of 14 per cent over the previous year. The average increase over the past five years was 17 per cent. This amount represents a per capita travel cost of $1,700 per employee on strength. Travel expenditures have increased steadily over the years at a higher rate than the increase in the travel price index. Travel and related costs have become a significant area of expenditure requiring greater management participation, monitoring and control.

2.39 Although Treasury Board introduced a restraint on discretionary travel in September 1982, it was not possible to measure its success because of the lack of an adequate definition of discretionary travel, and the lack of data on the extent of such travel.

Managing Travel

2.40 We conducted tests of management practices and controls in the following departments: Environment, External Affairs, Fisheries and Oceans, Indian Affairs and Northern Development, and National Health and Welfare. From our examination of a representative sample of claims in these five departments, we estimate that the amount of overpayment of the related travel expenses is $1.2 million, or 1.5 per cent. Except for the significant weaknesses noted below, these claims were in general compliance with government travel policies. The management of travel concentrated mostly on review and audit of travel claims, and improvements were needed in the areas of budgeting, management information, and providing management guidelines. The Treasury Board's travel policy is generally satisfactory and provides a consistent set of rules for determination of allowable travel expenditures. However, it tends to generate a significant amount of paper work and processing costs. The Office of the Comptroller General and the Treasury Board Secretariat are currently investigating the potential for reducing such costs.

Weaknesses in Management Practices

2.41 Our review of management practices relating to travel in the five departments indicated significant weaknesses in several areas. First, pre-authorization procedures were not being complied with in many cases. Second, there was a lack of control over the issue of airline tickets in some cases, due to poor departmental practices for controlling travel authority numbers and verifying Central Travel Service's billings and monthly statements of accounts. Third, we found little evidence that operational managers applied travel management practices and techniques that could have resulted in a more economical and efficient use of resources.

2.42 Government travellers make relatively little use of reduced airline fares available through advanced bookings and excursion fares.

CTS Financial Functions and Operations

2.43 Our examination of Central Travel Service's financial functions and operations and its contractual arrangements with Air Canada and CP Air for travel reservations revealed that the agency is achieving economies in accommodation and car rentals. However, its central payment and billing service does not demonstrate due regard for economy and efficiency.

Duplication of Administrative Tasks

2.44 Central Travel Service, for a one per cent collection fee, purchased $97 million in airline tickets on behalf of departments and agencies in 1983-84. The two major Canadian airlines' accounts are paid directly by the central payment system and are collected later from departments and agencies. We believe that this intermediary activity is not necessary to the provision of a central travel service. Central Travel Service has been unable to collect its past-due accounts promptly and to provide accurate statements of accounts to customer departments and agencies. These accounts averaged $14 million during 1983-84. The central payment system has led to duplication of administrative tasks and unnecessary cost to government.

CHAPTER 8 - MANAGEMENT OF JOB CLASSIFICATION

2.45 Job classification is an integral and important part of employee compensation in the federal public service. It is a process by which the relative worth of federal public service jobs is determined and through which each job is assigned to an occupational group and level. The actual rates of pay and other terms and conditions of employment for a particular occupational group and level are determined either through collective bargaining or unilaterally by the employer, Treasury Board.

2.46 In the federal public service, the job classification system covers about 222,000 employees service-wide and is managed by the Treasury Board Secretariat on behalf of the Treasury Board. It is characterized by extensive delegation of authority to deputy heads of departments and heads of agencies to classify jobs.

Recent Audit by Treasury Board Secretariat

2.47 Numerous government studies in the past 10 years have repeatedly indicated significant problems in public service job classification. The most recent service-wide audit by Treasury Board Secretariat of the accuracy of classification decisions indicated a rate of misclassification approaching 25 per cent of all positions. About 80 per cent of the misclassifications (19 per cent of all positions) involved over-classification. Based on Treasury Board Secretariat's audit findings, this means that about one in every five public servants was overpaid in relation to other public servants. The cost of over-classification amounted to 2.7 per cent of the straight-time payroll for the sample of positions that Treasury Board Secretariat audited.

2.48 Treasury Board Secretariat estimated the net cost of classification errors (the total cost of over-classified positions less the cost reductions of the relatively few under-classified positions) to be about $125 million a year, or 2.4 per cent of straight-time payroll. This estimate did not include the associated costs of employer-paid, salary-related benefits and other entitlements.

Scope of Our Audit

2.49 This year, we examined the management of the public service job classification system at the Treasury Board Secretariat level and in departments. We also reviewed processes for classifying jobs in a variety of private, public and quasi-public organizations to develop an appreciation of current state-of-the-art management practices in the field.

Pressures on the System

2.50 Our findings indicate that the public service classification system is under considerable upward pressure from a variety of sources and that the countervailing forces – good management practices, effective accountability relationships and related reporting mechanisms – are not sufficiently strong to offset these pressures.

2.51 There has been a noticeable shift in the distribution of public servants from lower to higher paying levels in several occupational groups. The rate of promotion of public servants without competition, as a result of upward reclassification of their jobs, increased by about 33 per cent between 1980 and 1983 and, in the last year, accounted for one in five of all promotions. The number of promotions resulting from reclassification has fallen somewhat during this period but not in proportion to the overall volume of promotions of all types, which dropped from a high of 30,062 in 1981 to 19,949 in 1983.

Deficiencies in Management Controls Over Classification

2.52 We found significant deficiencies in management controls over job classification at both Treasury Board Secretariat and departmental levels. For example, Treasury Board policies for job classification could be significantly improved in both content and clarity; classification standards, the fundamental working tool for making classification decisions, are frequently lacking in currency; and the Secretariat has not established a specific performance standard with regard to the rate of misclassification.

2.53 At the departmental level, key management controls, such as monitoring and auditing of classification activities, were generally weak. In the one department where they were strong, the incidence of classification errors identified through Treasury Board Secretariat's audit was markedly lower than in other departments with less effective or non-existent controls. We noted that departments frequently do not comply with Treasury Board Secretariat job classification policies. Departments have been very slow to correct positions identified as over-classified through Treasury Board Secretariat audits. These problems have been known to Treasury Board Secretariat for some time; yet, apart from service-wide restrictions affecting all departments, we have not found a single instance where sanctions were applied in individual departments. Such sanctions could include restricting or withdrawing delegated classification authority in departments where problems are known and are not corrected.

Lack of Accountability for Classification Decisions

2.54 Finally, the current system has no operating mechanisms by which those with authority for classification decisions at all levels – deputy heads, associate deputy heads, personnel specialists, or Treasury Board Secretariat – are effectively held accountable for exercising their authority. In fact, the Treasury Board Secretariat does not currently receive information on the nature, extent or cost implications of classification activities in departments, nor is such information reported to Treasury Board or to Parliament.

Government Initiatives

2.55 In response to its most recent service-wide audit of the accuracy of classification decisions, Treasury Board Secretariat has undertaken the development of a system to monitor the cost implications of classification changes in departments. It has also implemented measures intended to improve the audit and monitoring of classification decisions and to control the upward reclassification of jobs. These measures will likely address some of the problems identified in our audit.

Audit Conclusions and Recommendations

2.56 We do not believe that sweeping fundamental changes to the structure of the public service job classification system are either necessary or desirable, in view of the potential costs and disruptive effects of such changes and the availability of opportunities for improvements in the management of the current system. Nor do we believe that further procedural controls or constraints are the answer. Our recommendations are directed at achieving greater accountability for the management of the existing system – in particular, the cost implications of organization change and the related classification decisions. They are also directed toward more effective measures to ensure the quality or correctness of classification decisions as they are made and toward more effective control over the system through conducting systematic, integrated and co-ordinated audits of classification decisions and through applying sanctions, where appropriate, when classification problems are not corrected.

2.57 Our recommendations include the proposal that Treasury Board report annually to Parliament on its stewardship of public service job classification. In our view, accountability for the integrity of the system is the most fundamental issue to be addressed.

Reporting to Parliament would increase the visibility and resulting scrutiny of job classification and, ultimately, enhance accountability at all levels for managing the system.

CHAPTER 9 - CANADIAN INTERNATIONAL DEVELOPMENT AGENCY

2.58 The Canadian International Development Agency (CIDA) is the major responsibility centre for delivering Canada's aid to the developing world. With a budget of $1.4 billion in 1983-84, CIDA programs are designed to improve the overall conditions of life in the poorer nations of the world and to support Canadian foreign policy considerations of social justice, economic interest, global peace and security.

CIDA's Four Main Program Components

2.59 CIDA program aid is delivered through four main program components. Bilateral aid is project-oriented assistance and is a primary link between Canada's technological and industrial base and Third World development opportunities. Special Programs provide developmental assistance in response to the initiatives of various non-governmental organizations. Multilateral assistance provides financial contributions to international development organizations, such as the United Nations, that pursue objectives acceptable to Canada. Food Aid consists of humanitarian and developmental assistance using Canadian commodities to relieve world hunger.

The Complexity of Program Delivery

2.60 In comparison to other donor agencies, CIDA has a broad, centrally administered mandate. Although this increases the opportunity to link programs centrally in Ottawa, it also increases the complexity of program delivery. Regardless of the organizational arrangements involved, clear direction to program officers in the branches and at Posts abroad is essential.

2.61 Canadian aid is delivered in a complex national and international environment. There are many links between the economy of Canada and the developing world as well as between viable development projects and future trade opportunities. These links are subject to international competitive pressures to deliver aid promptly and effectively in a manner conducive to future economic considerations. Canada's reaction to these pressures has not always been as responsive as some other nations delivering aid to the Third World.

2.62 In the countries that we visited, we found that, once mobilized, CIDA projects are well received by the recipients and generally respond well to identified development needs. Canadians working on projects exhibit a high degree of commitment to project objectives. Canadian participants are usually under contract to CIDA and report to CIDA Headquarters through the Canadian Embassy.

Bilateral Aid

2.63 Accountability for CIDA's bilateral programs is not clear to all participants. The Agency manages the process of project delivery and is directly responsible for results. It is only through close control over the quality of project results achieved through Canadian aid that there can be assurance that funds are being used effectively.

2.64 The Agency acknowledges that one of its roles is developing closer ties between the Canadian economy and the Third World. However, there are specific problems in carrying out this role. This is evident in project identification and approval procedures that are lengthy and not sufficiently oriented to identifying Canadian economic opportunities. Also, once approved and mobilized, not all projects are closely monitored for results. Completed projects are usually evaluated, but the mechanisms to ensure that lessons learned are transferred to new projects are inadequate.

2.65 Project team leaders and field officers do not have sufficient technical support to evaluate the implications of operational problems that appear in almost all developmental projects. Decisions on operational issues are usually referred to Headquarters; because of communications difficulties and insufficient technical support, this procedure often leads to delays.

2.66 Planning of projects is a long and arduous process that often takes years. The Country Program Reviews are intended to be a master plan for specific recipient countries. These plans are not used to any significant extent. Until recently, they have tended to focus on past activities rather than presenting a plan to achieve specific objectives related to Canadian policy. CIDA is continuing to modify the Country Program Review process to increase the efficiency of planning efforts and to reflect future planning requirements.

2.67 Some key tasks within project delivery are not adequately controlled by CIDA. Procurement is inadequately planned and often unco-ordinated. Procurement Division is monitoring only 40 of 240 projects on which monitoring is required. Other monitoring activities are carried out by procurement agents and implementing agents under contract to Bilateral Branches. However, Procurement Division did not know how well these activities were being performed. Although project activities are usually costed in the plans, these costs are not adequately monitored during implementation.

2.68 Project evaluation to develop a corporate memory and build on experience needs to be improved. There is no overall framework to select and determine the timing for project evaluation. The use of evaluations depends on the experience and training of particular project officers. Many officers have received no training in the value and use of project evaluations.

2.69 Program evaluation is an important element of government policy. The Agency has attempted to develop acceptable evaluations of its programs, but, in the case of bilateral programs, it has been unable to develop a workable methodology to evaluate results at the program level.

Multilateral Aid

2.70 Multilateral aid is well managed. Canada has played a lead role in the United Nations family of agencies. This role is commensurate with the level of contributions. Further, the Agency has developed a system of institutional appraisals to determine the extent to which these organizations are pursuing goals acceptable to the Canadian aid program.

Food Aid

2.71 A broad variety of organizational units, both within and outside CIDA, is involved in planning, administering, implementing and monitoring the Food Aid Program. Responsibility is spread over many units and, while each unit is accountable for its own activities, the number of participants makes it difficult to determine who, if anyone, is accountable for the overall process. This heightens the possibility of errors that could have a negative effect on the impact of the program and on Canada's image as a donor and major exporter of food. Although some problems in program administration and control are within CIDA's control, others lie outside the control of the Agency. There is a need to re-examine the organization, administration and accountability of the Food Aid Program.

Special Programs

2.72 CIDA's link to the initiatives of many Canadians working in developing countries is through the non-governmental organization (NGO) and private sector community. These groups, working at the grassroots level, receive part of their financing through the Special Programs Branch. The number of projects delivered through Special Programs Branch has increased significantly over the last four years. However, its management systems have not kept pace with CIDA's needs. Information needed for decision making has not been identified or documented. We found insufficient information on file concerning projects supported by Special Programs Branch funds.

Support Groups

2.73 Agency support groups have made progress since our last audit in 1979. Some major concerns have been recognized and dealt with in the Comprehensive Agency Management Plan. A number of deficiencies identified in our 1979 audit have been rectified; however, certain aspects of the overall Plan still need to be improved. Some target deadlines for 1984 have been moved to 1986-87, and the Plan's budget increased from $13 million to $21 million. The Agency Long Range Systems Plan is about two years behind schedule and information needs for project and corporate management were not scheduled to be fully met until October 1984.

Project Results

2.74 CIDA is fortunate to have a staff of dedicated officers. Current procedures, however, place inadequate emphasis on the quality of individual project results. Time required for project mobilization needs to be significantly shortened to match other major donor countries. Variables that affect prompt and effective project implementation need to be identified and monitored by project leaders with project management experience and adequate technical support. The role of Posts abroad needs to be clarified in terms of responsibility for project monitoring and following up completed projects. Successful projects that enhance Canada's reputation for excellence, as well as failures and their causes, need to be highlighted within CIDA to ensure that lessons learned are communicated throughout the Agency. The Agency needs to reinforce the emphasis on accountability for project results.

CHAPTER 10 - NATIONAL ENERGY BOARD

2.75 The National Energy Board, established in 1959, controls energy imports and exports, regulates the construction and operation of interprovincial and international energy transmission projects, and administers two programs on behalf of the federal government. It regulates 39 oil and gas transmission pipelines and about 100 international electric power connections, but it has no regulatory authority over coal or nuclear power. It is a court of record with full and exclusive jurisdiction over matters in its areas of operations. Some of its decisions have the force of law; for others, the concurrence of the Governor in Council is required. Under certain circumstances, its decisions may be appealed to the Federal Court of Canada.

2.76 The value of gross energy exports exceeded $11 billion in 1983, and regulated imports and interprovincial trade exceeded $20 billion. The value of regulated pipeline tolls was about $1.6 billion in 1983.

2.77 We audited management controls over the analysis supporting the Board's regulatory decisions as well as the Board's procedures to foster economy in the construction of regulated pipelines and efficiency in their operations.

Analytic Support for Decision Making

2.78 The National Energy Board Act gives the Board extensive discretion in making regulatory decisions. In general, it may take into account any matters that to it "appear to be relevant". In certain cases, it may consider such things as the supply of gas or oil to a pipeline for transportation, the existence of actual or potential markets, and the supply of and demand for Canadian energy. Analytic support for the Board's decision making is therefore critical and must be extensive.

2.79 We audited most of the analytic support functions. For the toll administration process, we relied on internal audit. We found no significant weaknesses in these functions and found that the functions were generally well controlled.

Encouraging Economy and Efficiency

2.80 As a regulator of interprovincial and international transmission of energy, the Board first certifies whether proposed transmission facilities are a present and future public convenience and necessity. After construction, it sets and regulates transmission tolls to ensure that they are just and reasonable. In general terms, tolls are set for each transmission company so that it may recover its costs of service and earn up to an allowed rate of return on the rate base portion of its invested capital. There are advantages to this approach, including its simplicity as a concept and the assurance it provides of adequate profit, which in turn encourages needed investment. However, these are offset by some disadvantages. Rate base regulation tends to create a natural incentive for pipeline operators to spend more than the optimum amount on their base rate. Further, there may be no direct incentives for pipeline operators to control operating costs, because they can be recovered in the tolls. In Canada, this latter disadvantage is aggravated by the fact that oil and gas prices are fixed by decree. This eliminates restraints on cost increases that would normally be present in the marketplace because of the need to be competitive with alternative sources of energy.

2.81 **Audit expectations.** In the absence of natural market incentives for cost-efficient construction or operation of transmission pipelines, we would expect the Board to have instituted substitute controls and checks that would have a compensating effect. Over the years, the Board has instituted several of these and is currently implementing or studying others. Nevertheless, we believe the Board could increase its efforts to encourage economy and efficiency of regulated pipelines. This will not be an easy task.

2.82 **Initiatives by the Board.** Since 1979, tolls on some pipelines have been set to incorporate incentives for economy and efficiency. As a consequence of a Board study of pipeline costs, the Board and the industry are examining incentives and procedures for controlling construction costs. The Board staff recently studied the possibility of requiring transmission companies to conduct comprehensive audits.

2.83 In its review of an application for a major construction project, the Board does an analysis to ensure that an applicant's overall design is close to the least-cost design. The Board frequently disallows costs for toll determination purposes.

2.84 **Opportunities for improvement.** Improvements could be made by requiring the transmission companies to report on their efficiency and to conduct occasional economy and efficiency audits. Currently, National Energy Board auditors conduct compliance audits of regulated companies to ensure they are keeping their accounts in the prescribed way, but they do not explicitly attempt to identify improper or imprudent expenditures. We believe that audit work focused on identifying such expenditures would strengthen the process.

2.85 The Board makes its decisions on applications for pipeline installation in two stages. First, on the basis of estimated cost, markets, supply and so on, it determines whether a proposed pipeline "is and will be required by the present and future public convenience and necessity". Second, after construction, it decides, on the basis of actual construction costs and estimates of operating costs, on a just and reasonable toll. In our view, this process could be strengthened if firm construction cost estimates were required prior to construction on all projects, if there were occasional post-construction management audits, and if construction progress monitoring were routinely done by the Board.

Other Points

2.86 The Board's process of controlling energy exports is satisfactory, except for oil exports by truck. Exports by truck of oil, oil products and liquid petroleum were reported by Statistics Canada to have had a value of $635 million in 1983. Since the Board does not know how much unlicensed exporting there is, it does not know whether this constitutes a significant problem and thus how much effort would be justified in attempting to resolve it.

2.87 The Board has satisfactory administrative procedures for preventing conflicts of interest and avoiding the appearance of bias. It also has an extensive program for improving its regulatory procedures.

CHAPTER 11 - DEPARTMENT OF THE ENVIRONMENT

2.88 The Department of the Environment (DOE) is concerned with fostering harmony between society and the environment for the benefit of present and future generations of Canadians. Because of its many diverse and complex activities, we have adopted a phased approach to the audit of the Department.

Environmental Conservation Service

2.89 The first phase, dealing with Parks Canada, was reported last year. This year, we are reporting on the second phase, focusing on program management in the Environmental Conservation Service (ECS). ECS promotes the sound management and development of three resources: inland waters, wildlife, and land. Our audit concentrated on the two major activities associated with inland waters – providing quantitative data on river flows and lake levels, and performing research on the biological, chemical and hydrological aspects of water. As a result of our audit work, we reached the following conclusions:

- The system for collecting, processing and disseminating quantitative data relating to water gave due regard for economy and efficiency and was generally well managed.

The research activity was providing only limited benefit to managers of water.

Financial Management and Control

2.90 We selected financial management and control for our audit of a department-wide function. Departmental policy gives the corporate finance group functional authority over all aspects of departmental financial administration, including counterpart groups in the various Services. The financial group employs a persuasive approach in exercising this authority, through involvement in various management processes. However, this approach does not provide an adequate independent check over delegated authority and consequent accountability.

Grants and Contributions - Canadian Forestry Service

2.91 We reviewed Grants and Contributions in the Canadian Forestry Service (CFS). These have significantly increased since CFS took over federal-provincial agreements from the former Department of Regional Economic Expansion and began participating in job creation programs sponsored by Employment and Immigration Canada. We observed deficiencies in the management of these agreements. As a consequence, the Department could not be sure that the desired results of the programs were being achieved.

Management Response to Recommendations

2.92 We received assurances from management that corrective action in respect of our findings and recommendations was either under way or contemplated in the near future.

CHAPTER 12 - DEPARTMENT OF NATIONAL DEFENCE

2.93 After 15 years, the Department of National Defence continues to adjust to the effects of having adopted a unified and integrated structure. Furthermore, significant components of the management process continue to be revised. These include force structure planning, strategic planning, personnel planning, guidance to field operations, command and control, supply and logistics, costing systems, financial reporting and control, and information feedback. In our opinion, efforts to upgrade these individual elements can best be made as integral components of an overall concept of the departmental management system.

Need for a Long-term Force Structure Plan

2.94 A military force structure consists of two major components which, in combination, produce military capability. These components are suitably trained personnel, and equipment (including infrastructure). The effects of short-term decisions concerning military personnel and equipment can have important effects over a 20 to 30-year horizon. Commitments to allies, however, can change both in nature and scope over a much shorter time, as can the roles, tasks and objectives assigned by the government of the day. In addition, the determination of military requirements deemed sufficient to meet any particular commitment is a subjective process which relies heavily on professional military judgement. This process is also greatly affected by changing perceptions of the precise nature of threat, the commitment, and the appropriate type and level of response. All these can change over a much shorter time than that required for personnel and equipment changes.

2.95 There appears to be a need, therefore, for longer-term planning targets, consistent with agreed funding levels, which can be used to stabilize short-term decision making. Such a plan for the longer term would provide stability to the force structure and the resource allocation process. It would also provide a firm basis for considering shorter-term options designed for tailoring current capability to existing commitments. The Department has recently initiated a Normative Planning process, designed to determine war and peace force structure requirements. We support this important step toward resolving problems.

Planning, Control and Evaluation

2.96 We audited the planning, control and evaluation aspects of the departmental management system. This included a review of the policy framework, strategic or capability planning, guidance to commanders, and elements of the feedback process. We found that the force structure currently used for resource allocation is out of date and inadequately defined. Key documents critical to the top four stages of the strategic or capability planning process were out of date, had not been formally amended and approved, or had other major deficiencies. We found problems in the area of guidance to commanders and deficiencies in the feedback processes. The Department agrees that one of its main tasks will be to focus on improving and developing a planning, control and evaluation process that is clearly articulated both internally and externally.

Personnel Planning

2.97 We reviewed departmental systems for military and civilian personnel planning. The military personnel system, which caters to the lifetime requirements of a volunteer force of 82,000, is the largest and most complex in the Department. Unlike most other personnel systems, there is virtually no entry above the most junior levels and little mobility between classifications or trades. Personnel planning for a military force requires a long time frame – from 15 years to as much as 35 years. Because of this, consistency and stability in personnel policies are critical to short-term efficiency, overall effectiveness and morale. The absence of a well defined and approved force structure plan for the longer term has resulted in military personnel planning being focused on short-term requirements. This has limited the capacity of the personnel system to support the force development process.

Capital Acquisition Projects

2.98 We audited seven capital acquisition projects, each with a total cost exceeding $100 million (CF-18 aircraft, Aurora long-range patrol aircraft, Leopard tank, 2.5-ton truck, general purpose armoured vehicle, Canadian Patrol Frigate, and Destroyer Life Extension Program). Several of these projects involve a high level of technical sophistication, considerable risk and many uncertainties. Although we observed a high degree of dedication on the part of managers in attempting to deliver the best possible product with the funds provided, we also observed a number of shortcomings.

2.99 In general, the Department was able to link these projects to departmental objectives and tasks; however, it was difficult for DND to explain how the numbers and types of equipment selected demonstrated due regard for economy and efficiency in relation to a long-term force structure plan, or the extent to which they represented an optimum strategy for maximizing overall defence effectiveness within available resources. In most projects, the definition of support requirements and costs was not fully developed when funding was approved. Some projects suffered from the combined effects of cost escalation related to developmental aspects and the fixed budget ceiling imposed on the project. In these cases, there was a tendency for essential spare parts, support and other associated requirements to be submitted as follow-on projects in the capital or operating votes. As a result of these and other problems noted during the audit, we observed instances of delay, cost escalation, lower than anticipated serviceability rates, and sub-optimal maintenance practices.

2.100 We reviewed 12 capital construction projects totalling an estimated $308 million. With the exception of the base development project at CFB St-Jean, we found these were being managed satisfactorily. However, we believe that equipment acquisition and capital construction projects of the magnitude managed by the Department should be regularly reviewed on completion to determine whether original performance, cost, scope and timing objectives have been achieved.

2.101 Industrial benefits resulting from major capital projects play an important part in decisions on equipment options. We examined industrial benefit provisions, expected to amount to $3.2 billion, pertaining to the CF-18 fighter aircraft. We had reservations about how these provisions were defined, monitored and audited. The Department of Regional Industrial Expansion, which manages this process, has initiated a review of offset objectives and planning and control requirements.

Resourceful Officials

2.102 Throughout our audit, we were impressed by the dedication and resourcefulness of officials in searching for more effective and efficient ways of delivering programs. In the area of military training, for instance, we found several examples of innovative attempts to deliver training in facilities that were often out of date and over-utilized.

Automated Data Processing

2.103 In our 1982 Report, we recommended that the Department upgrade its automatic data processing (ADP) systems to meet future operational requirements. In this audit, we reviewed the operational readiness and capacity of 13 critical information systems, and our current findings reinforce our 1982 recommendation. Adoption of an ADP strategic plan, clarification of responsibilities, and improved system development practices are needed to redress the deficiencies.

Financial Administration Processes

2.104 Financial administration processes in the Department satisfy central agency guidelines on budgetary allocation and control. However, we noted areas where the roles and responsibilities of the Senior Financial Officer should be strengthened.

CHAPTER 13 - DEPARTMENT OF PUBLIC WORKS

2.105 The mission of the Department of Public Works (DPW), as stated in its 1982-83 Annual Report, is:

> to manage real property for the Government of Canada, and to provide planning, design, construction and realty services to government institutions, departments and agencies, while contributing to the achievement of the government's wider social, economic and environmental objectives.

2.106 In carrying out our audit, we examined the key activities in each of the Department's programs, paying particular attention to the costs and outputs of these activities.

Accommodation Program

2.107 **Leasing.** In providing accommodation services to other government departments and agencies, DPW operates under severe constraints arising from changing government priorities, reluctance of clients to provide information on a timely basis and the unpredictability of an ever-changing real estate market.

2.108 In our opinion, even taking these constraints into account, the leasing activities of the Department were not always managed in accordance with Treasury Board's and the Department's own directives and policies, especially in the National Capital Region. This is not because of a lack of policies and directives but because there appears to be no effective mechanism to ensure that the Department itself and its client departments and agencies comply with them. In a number of instances, the Department has not followed the public tendering process and entered into long-term leases on unfavourable terms.

2.109 Our examination disclosed a number of leasing transactions which had been carried out without due regard to economy. The total additional cost to the Crown as a result of the transactions that came under our review amounts to approximately $63 million. The

Crown also lost the opportunity to acquire a newly refurbished building, which DPW is now leasing, valued at $46.5 million in 1981, for an additional payment of only $15 million over the present value of its lease payments. In addition, the Department could not provide key supporting documents relating to lease offers and amendments for three major buildings in downtown Ottawa.

2.110 **Lease-purchase.** The Department, with the approval of Treasury Board, has entered into eight major lease-purchase arrangements, the total payments for which amount to $1.9 billion. The construction and financing costs of these capital acquisitions have never been disclosed to Parliament.

2.111 Under lease-purchase agreements, the Department makes monthly payments which are not based on fair market rentals but on amortization of the construction and financing costs by the developer. Because the Crown's borrowing power is stronger than that of a private developer, the financing costs of lease-purchase acquisitions are considerably higher than those of other Crown-financed acquisitions. We estimate the excess financing cost to the Crown with respect to four recent lease-purchase arrangements to be approximately $86 million, having a present value of $14.9 million.

2.112 **Occupied space.** Recent DPW documents indicated that departments are currently occupying space in excess of Treasury Board standards that could range between 152,000 and 305,000 square metres, at an annual cost of approximately $120 per square metre.

2.113 In addition, the Department's latest IMPAC/revenue dependency plan indicates that a five per cent reduction in gross rents can be achieved through space optimization at an annual saving of approximately $35 million.

2.114 **Unoccupied space.** The unoccupied space in the Department's inventory is not being properly managed. The data base relating to it is unreliable, inaccurate and out of date; as a result, the Department does not know the magnitude and total cost of unoccupied space. Our examination of 47 per cent of the Department's reported unoccupied space identified a cost to Canadian taxpayers of $22.6 million in grants in lieu of taxes and operating and maintenance expenses alone. In the properties we examined, the main causes of unoccupied space were changing government priorities, surplus properties transferred to the Department, and poor planning by DPW and its clients. Because of the nature of its portfolio and the lack of cost avoidance incentives in government, the Department's vacancy rates cannot be compared to those in the private sector.

2.115 **Energy conservation.** The Department has achieved progress in reducing the annual level of energy consumed in government facilities. DPW has also implemented programs to encourage the development of solar energy.

2.116 **The budgetary process.** The Department has achieved some improvements in the structure of its budgetary system. However, the foundation for sound operational planning and control is still incomplete. While some initiatives are under way, none of our 1979 recommendations designed to remedy serious deficiencies and provide property managers with necessary management tools has been fully implemented.

IMPAC/Revenue Dependency

2.117 Following qualified Cabinet approval in January 1981, the Department undertook the complex, unique and ambitious job of implementing revenue dependency, combining it with IMPAC (Improvement in Management Practices and Controls) activities. The Department embarked on this project without a proper analysis of the magnitude of the costs involved. Initially, the project costs were estimated at $3.7 million, subject to modifications as a result of system diagnostic work, and clients were to be charged for accommodation and realty services by April 1984. Revised plans based on gradual implementation provide for costs of $45.8 million, with a target completion date of April 1986. The Department states that its original estimate related only to certain IMPAC projects and excluded some $40.8 million required for improving various management systems.

2.118 We note that the full costs of the project were not estimated until three years after the project had been started. In our opinion, given that the Department has been fully aware for many years of the need to improve its systems, the total costs of the project should have been estimated and disclosed to Treasury Board at the outset.

Marine Program

2.119 **Dry dock operations.** The tariffs for the use of two of the three dry-dock facilities managed by the Department have not been changed since 1971 in one instance and 1965 in another. As a result, the Crown has had to absorb operating losses of $8.6 million since 1977. The Department states that these losses are a component of its "Support to Industry" mandate. However, in our opinion, these losses constitute an unauthorized and undisclosed subsidy to the two principal users of the facilities.

2.120 **Dredging operations.** Our 1980 recommendations and those made by the Department in 1981, both aimed at improving the economy and efficiency of its dredging operations, have only been partially implemented.

Professional and Technical Services Program

2.121 **Architectural and Engineering Services.** Our examination revealed that the Department does not have an effective system in place to ensure that the operations of its Architectural and Engineering Services are being carried out with due regard to economy and efficiency.

2.122 Although they are used in the private sector, the Department does not use norms for allocating resources to its various projects. While some norms are being used to plan resources at the macro-level, control over the use of resources is weak.

2.123 The information contained in the Time Report/Project Monitoring System, and used for overall monitoring of projects, is not consistent with the information kept in project files. In all the regions, important information was not readily available in the majority of the projects reviewed.

2.124 The mandate and role of the Headquarters Technology Branch are inhibited by a lack of clarity and a lack of acceptance by DPW regional offices.

Management Audit and Program Evaluation

2.125 In the seven years since it was established, the Management Audit function has acquired a good knowledge and understanding of DPW as an audit entity. It operates effectively as an integral part of the management control process, and there is visible evidence indicating that it has been an important participant in effecting positive change within the Department.

2.126 The Program Evaluation unit, established in 1982, has an infrastructure consistent with our criteria for establishing and operating such a unit.

Department's Response

2.127 The Department advises us that it agrees with our recommendations as set out in Chapter 13 and is taking steps to implement them. A senior manager has been assigned to ensure prompt implementation.

CHAPTER 14 - SECRETARY OF STATE

The Department's Mandate

2.128 The mandate of the Department of the Secretary of State is to contribute to the development, among present and potential Canadians, of a sense of belonging to the nation by permitting them to grow freely in a multicultural society within a bilingual framework.

2.129 The Department fulfils its mandate through four programs: Official Languages; Education Support; Citizenship and Culture; and Administration and Regional Operations. In 1983-84, it had a budget of $2.8 billion and 3,210 person-years.

2.130 A significant portion of the Department's person-years – 59 per cent – is assigned to the Official Languages Program, which includes the Translation Bureau. Eighty-one per cent of total financial resources is devoted to the Education Support Program. When our audit began, the organization supported the programs and activities of two ministries; it now supports three. An organization chart is in Chapter 14.

Guidance from Managers

2.131 The Secretary of State was already aware of most of the shortcomings we identified. The Translation Bureau and the Canada Student Loans Program had undertaken several studies to analyse various facets of their operations. As a result of these studies, recommendations were made in several instances where there were major deficiencies to correct. Our audit showed that the managers involved had not given the guidance necessary for ensuring timely decisions and for monitoring operations.

Deficiencies in Citizenship Registration Corrected

2.132 Although we identified problems in Citizenship Registration, management took appropriate steps during our audit to correct deficiencies.

Translation Services

2.133 The Translation Bureau, which is responsible for providing translation services to departments, has not completed an analysis of the relative costs and benefits of using internal or external resources. Monitoring of translators' productivity, work load and the quality of service to clients is generally inadequate. The Bureau is not able to interrelate the quality, quantity and complexity of its work. Consequently, it has no solid basis to support its need for internal resources or its decisions to contract work.

Education Support Program

2.134 As the central agency responsible for co-ordinating federal policies related to education, the Secretary of State has defined objectives in the field of education. The Secretary of State has made efforts toward ensuring co-ordination of activities among federal departments and agencies and between the federal government and the provinces, but the appropriate mechanisms and strategies have not yet been defined satisfactorily. The Department is in the process of establishing methods of assessing the achievement of its federal objectives and is attempting to enhance provincial accountability for the federal funds provinces receive under the Federal-Provincial Fiscal Arrangements and Established Programs Financing Act.

Canada Student Loans Program

2.135 Since 1977, we have identified serious deficiencies in the internal control of the student loans EDP system and made recommendations to improve the situation. The internal control of the EDP system for the student loans program is still weak. Our audit showed that, despite numerous attempts and considerable expenditures over the last few years to install a new EDP system, the detailed design of the new student loans system had only just been started.

AUDIT NOTES

AUDIT NOTES

Table of Contents

	Paragraph	Page
Introduction	3.1	3-1
Observations on Crown Corporations	3.2	3-1
Canada Deposit Insurance Corporation - Unknown Ultimate Loss to the Corporation	3.3	3-1
Canadian Dairy Commission - Levies Instituted Beyond the Powers of the Commission	3.10	3-2
Canadian Saltfish Corporation - Sales, and Advances to Frozen Fish Producers, Beyond the Corporation's Statutory Powers	3.17	3-3
Loto Canada Inc. - Continuing Payments Beyond the Powers of the Corporation Used to Finance Sports Pool Scheme, and Other Concerns	3.21	3-4
Observations on Departmental Operations		
Department of the Environment - Non-use of Leased Property Still Unresolved After 10 Years	3.28	3-5
Department of Finance - Scientific Research and Development Tax Credit Program Implemented Without Adequate Safeguards Over Public Moneys	3.34	3-7
Department of Indian Affairs and Northern Development - Inadequate Accounting for Contributions of $500 Million to Indian Bands	3.50	3-9
Department of Indian Affairs and Northern Development - Questionable Safeguards over the Release of Indian Capital Moneys	3.56	3-10
Department of Indian Affairs and Northern Development - Reimbursement of Education Costs Totalling $2.6 Million Made Without Parliamentary Authority	3.60	3-11

Audit Notes

	Paragraph	Page
Department of Indian Affairs and Northern Development - Education Costs Paid Twice	3.63	3–12
Department of Indian Affairs and Northern Development - Loss Due to Unauthorized Issue of Timber Licence	3.66	3–12
Department of Regional Industrial Expansion - Deficiencies in Purchase and Sale of LRC Trains	3.69	3–13
Department of Transport - Annual Earnings Retained by Seven Harbour Commissions Without the Minister's Authority as Required by Parliament	3.77	3–14
Department of Transport - Excess Funds of $74 Million Provided to VIA Rail	3.81	3–15
Department of Transport - $46.8 Million Double Payments Made to Canadian National Railways in 1979 and 1980 Not Returned to Consolidated Revenue Fund	3.86	3–17
Exchange Fund Account - Valuation of Gold and Accounting for the Realized Gains on Sales of Gold	3.90	3–17
Questionable Compensation Payments Involving Management Staff	3.94	3–18
Report Under Section 11 of the Auditor General Act on our Continuing Review of the Oil Pricing and Compensation Programs	3.100	3–19
1984 IMPAC Progress Review	3.117	3–24
Major Capital Projects	3.137	3–29
Canadian Coast Guard - Deficiencies in Vessel Design and Acquisition Procedures	3.138	3–29

3

AUDIT NOTES

Introduction

3.1 This chapter contains matters of significance that we believe should be drawn to the attention of the House of Commons. **These matters have not been reported in either the departmental chapters or the government-wide studies, but have come to our attention during our audits of the accounts of Canada, Crown corporations and other entities.**

Observations on Crown Corporations

3.2 Our Office is the appointed auditor of 47 Crown corporations, as required by the Financial Administration Act or the individual act incorporating the specific corporation. Details on significant reservations and other matters contained in those reports issued during the year are set out below. Most of these matters have already been raised in the public forum, but they are repeated here for emphasis, and for consideration by the new Parliament.

3.3 Canada Deposit Insurance Corporation - Unknown Ultimate Loss to the Corporation

> The Canada Deposit Insurance Corporation anticipates heavy losses as a result of financial difficulties encountered by eight trust and loan companies. As of 31 December 1983, the Corporation had recorded a general provision for loss of $650 million, but recognized that there might be additional losses incurred during the winding down of the companies. Sufficient information was not available at the time of our audit to determine whether the $650 million provision was adequate.

3.4 The Canada Deposit Insurance Corporation was established in 1967 by the Canada Deposit Insurance Corporation Act. Its primary role is to provide insurance to persons having deposits in banks, trust and loan companies against the loss of all or part of their deposits, to a maximum of $60,000 per person per member institution.

3.5 During 1983, six member institutions encountered financial difficulties so serious that their business activities had to be terminated by the regulatory authorities. The CDIC became involved because of its mandate to protect depositors and to avoid instability in deposit-taking institutions. Under section 11(a) of its Act, the Canada Deposit Insurance Corporation entered into agency agreements with other member institutions to administer the assets and liabilities of the financially troubled companies and to ensure that their operations would be wound down in an orderly manner. During the term of the agreements, the agents are paying all liabilities on maturity.

3.6 In addition, a seventh member institution was placed in liquidation in 1983. An eighth member institution had been placed under an Agency and Operating Agreement in 1982 for the purpose of winding down its affairs in an orderly manner.

3.7 As of 31 December 1983, the Corporation had made loans to the eight troubled companies amounting to $942.5 million in order to fund payment of liabilities and operations. At March 31 1984, the amount of loans outstanding was $1 billion. The Corporation has a registered floating charge against all the assets of these companies to secure its loans. However, the Corporation anticipates heavy losses and has recorded a general provision for loss of $650 million at 31 December 1983. This was based on the accumulated deficits of the troubled companies at that date. The Corporation recognizes that the actual losses may be different from the provision because there may be additional losses during the wind-down period, due to changes in the value of assets on disposition, interest rate levels and a number of contingencies arising from potential judicial actions.

3.8 Because of these circumstances, sufficient information was not available at the date of our audit to allow us to determine whether the general provision was adequate. Accordingly, in our audit report to the Minister of Finance, we stated that we were unable to express an opinion on the financial statements of the Corporation for the year ended 31 December 1983.

3.9 In addition, our audit report noted that Parliament may be required to make amendments to the Canada Deposit Insurance Corporation Act to permit increased premium rates from member institutions or to otherwise change the funding provisions of the Act. The Corporation has not gone to Parliament at this time to seek such amendments.

3.10 Canadian Dairy Commission - Levies Instituted Beyond the Powers of the Commission

> In our opinion, levies are being assessed and collected from dairy producers by the Canadian Dairy Commission without proper authority. This matter, which was raised in our 1982 and 1983 annual Reports, is currently being addressed by the Commission. It is expected that a legislative mechanism will be in place within the year.

3.11 Section 12(f) of the Canadian Dairy Commission Act empowers the Governor in Council "to make regulations regulating the marketing of any dairy product, including regulations... authorizing the Commission to fix, impose and collect levies or charges from persons engaged in the marketing of any dairy product...and use such levies or charges for the purpose of carrying out its functions under this Act..."

3.12 Since the establishment of the Canadian Dairy Commission in 1967, no regulation concerning levies has been made pursuant to section 12. We have obtained two separate legal opinions which state that, in the absence of a regulation made by the

Governor in Council authorizing the imposition of levies, the Commission is powerless to impose them.

3.13 The Commission assesses levies to cover the cost of disposing of surplus dairy products. Producer levies for the dairy year ended 31 July 1983 amounted to $270.8 million, of which $6.9 million was collected direct by the Commission by deduction from subsidy payments to producers. Other deductions are made from payments by processors to producers on delivery of industrial milk and remitted to the provincial marketing boards, which, in turn, forward them to the Commission.

3.14 The Commission has obtained a legal opinion from the Deputy Minister of Justice that "the fixing, imposition and collection of levies has been validly adopted under the Agricultural Products Marketing Act."

3.15 Notwithstanding this opinion, our audit report to the Minister of Agriculture on the financial statements of the Commission for the year ended 31 July 1983 included a qualification that the producer levies have been instituted without benefit of regulation and are, therefore, beyond the powers of the Canadian Dairy Commission.

3.16 To correct this situation, the Commission is negotiating its relationship with provincial organizations in the assessment and collection of producer levies as provided for in provincial and federal legislation. It is expected that this work, which involves extensive consultations with provincial officials, will be finalized this year.

3.17 Canadian Saltfish Corporation - Sales, and Advances to Frozen Fish Producers, Beyond the Corporation's Statutory Powers

> During the year ended 31 March 1984, the Canadian Saltfish Corporation made sales of $14.8 million of frozen fish products, and advances to frozen fish producers, which, in our opinion, were beyond its statutory powers.

3.18 The Canadian Saltfish Corporation was established by the Saltfish Act in 1970 to improve the earnings of the primary producers of cured codfish. The Corporation's operations are restricted by its Act to trading and marketing of cured codfish and its by-products in the Province of Newfoundland and the Lower North Shore of Quebec; it is required to buy all cured codfish of an acceptable standard of quality offered for sale by the fishermen.

3.19 During the year ended 31 March 1984, the Corporation marketed frozen fish products, under contracts with a number of producer companies. In accordance with certain of these contracts, the Corporation advanced up to 70 per cent of the projected market value of the fish products to the producer companies, with the balance payable determined by the ultimate selling price and any related expenses incurred. Between the time the advances were made and the end of the fiscal year, there was a substantial reduction in the selling price of frozen fish. As of 31 March 1984, advances were $1.2 million in excess of the frozen fish inventory, valued at $2 million. The Corporation has since changed its procedures in the current year to avoid making future excess advances and is endeavouring to recover excess advances outstanding.

3.20 In our opinion, because the Act specifies the Corporation's rights only in relation to cured codfish, sales of frozen fish products during the year, and advances to frozen fish producers, as outlined in the previous paragraph, were not within the powers of the Corporation under the Saltfish Act. Accordingly, in our audit report to the Minister of Fisheries and Oceans, our opinion on the financial statements of the Corporation for the year ended 31 March 1984 was qualified.

3.21 Loto Canada Inc. - Continuing Payments Beyond the Powers of the Corporation Used to Finance Sports Pool Scheme, and Other Concerns

> For the past three years, we have expressed a number of concerns in our audit report on the financial statements of Loto Canada Inc. In particular, to 31 March 1984, the Corporation has financed $2.1 million for the research and development of a sports pool scheme, an activity which, in our opinion, is beyond the powers of the Corporation. We also expressed concern that no arrangements had been finalized to pay $15.2 million surplus funds due to Canada. Moreover, administrative costs continued to be incurred as a result of the delay in winding up the Corporation.

3.22 Loto Canada Inc. was incorporated under the Canada Business Corporations Act in 1976 to conduct and manage a national lottery in accordance with the National Lottery Regulations. In August 1979, federal and provincial government representatives came to an understanding that Loto Canada Inc. would withdraw from the sale of lottery tickets effective 31 December 1979 and that the Corporation would then be wound up by the federal government as quickly as legal, financial and administrative requirements permitted. The lottery operations were terminated effective 31 December 1979, and the right to claim prizes expired on 31 December 1980.

3.23 In January 1981, the Corporation began financing research on gaming concepts, including research and development of a sports pool scheme. In August 1981, Cabinet decided that a sports pool would be operated by a new federal agency. This agency, the Canadian Sports Pool Corporation, was established on 20 October 1983.

3.24 Loto Canada Inc. takes the position that financing this research was a business decision within its general powers and in support of the intention of the federal government. However, in our opinion, it was not authorized under the Corporation's Articles of Incorporation, which restrict the business that the Corporation may conduct and manage.

3.25 Payments for research and development of the sports pool scheme by Loto Canada Inc. from January 1981 to 31 March 1984 amounted to a total of $2.1 million, of which $1.3 million has been recovered. Recovery of the balance of $.8 million due from Canada will require a further submission to Treasury Board. Treasury Board rejected a claim for a portion of this amount in December 1982, pending an investigation by the Department of Justice and the Office of the Comptroller General as to whether improper or illegal actions took place in certain work contracted for by Loto Canada Inc. This investigation is still going on.

3.26 On 7 July 1983, the Board of Directors of Loto Canada Inc. passed a resolution to begin the final winding up of the Corporation. On 31 December 1983, the last of the Corporation's employees were released, and the remaining professional service contracts were terminated. However, although the lottery operations were terminated in 1979, the Corporation has still not finalized arrangements to transfer $15.2 million surplus funds due to Canada and has incurred further administrative costs, amounting to $884,000 for the three years ended 31 March 1984, attributed to the delay in winding up this Corporation.

3.27 These matters were brought to the attention of the minister responsible for the Corporation in our audit reports on the financial statements of the Corporation for the 1982, 1983 and 1984 financial years.

Observations on Departmental Operations

3.28 Department of the Environment - Non-use of Leased Property Still Unresolved After 10 Years

> **In 1976, 1977 and 1978, we reported on rental payments by the Department of the Environment (DOE) for approximately 55 acres of land which, apart from a small portion sublet, were vacant. In 1978, the Public Accounts Committee recommended that this lease either be disposed of or that a change in use be negotiated. In 1984, the situation is basically unchanged, except that the annual rent, which began at $0.6 million, has now risen to over $1.3 million.**

3.29 The lease dates back to 1974 when, after acquiring an existing leasehold interest at a cost of $4 million, the Department entered into a 71-year lease of land from the Squamish Indian Band for the construction of a proposed Pacific Environment Centre in Greater Vancouver, a project which was subsequently cancelled.

3.30 The Department of the Environment has attempted to resolve this problem in conjunction with the Department of Public Works, which has primary responsibility in this area. Although it is six years since the Public Accounts Committee recommendations, the main portion of the lands is still unoccupied, and no tenants have been found.

Current annual rent is $1.3 million for this property in Greater Vancouver.

3.31 During the first 11 years of the lease, the government has paid in excess of $8.7 million (lease acquisition, rental and taxes) on the land. The rent is adjusted based on an appraisal every five years and is partly offset by the amortized cost of the original leasehold acquisition. Valuations and rentals are as follows:

	1974	1979	1984
Market value as appraised	$ 7,108,637	$ 8,315,000	$ 14,782,086
Rate of return used	8%	8½%	9%
Annual gross rent	$ 561,491	$ 706,775	$ 1,330,388
Less amortized acquisition cost of leasehold	(320,089)	(320,089)	(320,089)
Annual payment for five-year period	$ 241,402	$ 386,686	$ 1,010,299

3.32 We were informed by DOE that a rental for the 10-acre sub-lease had been negotiated recently for $215,000 a year. At the time of our audit, no rent had been collected.

3.33 Should the lease continue to its maturity in 2045, with future increases based on an inflation rate of 5 per cent, as opposed to the average annual increase over the first 10 years of 9 per cent, total rent payable would be in excess of $460 million.

3.34 Department of Finance - Scientific Research and Development Tax Credit Program Implemented Without Adequate Safeguards Over Public Moneys.

> In January 1984, amendments to the Income Tax Act were enacted to provide for a scientific research and development tax credit program. The program was introduced to make tax incentives of more immediate value to companies performing research and development (R&D) and to facilitate financing R&D. To achieve the first aim, the program was specifically designed in such a way that investors were able to realize quick, no-risk profits, by a procedure known as the "quick flip". This has caused a significant overrun in the cost of the program. On 10 October 1984, the Minister of Finance announced a moratorium on "quick flip" transactions. Although neither the Department of Finance nor the Department of National Revenue - Taxation was able to provide us with actual program costs, tax credits issued to investors to 6 October 1984 approximated $1.6 billion. Moreover, we are concerned that this program could result in bad debts for the government.

3.35 In April 1983, a proposal prepared by the Department of Finance to improve the effectiveness of research and development tax incentives was presented to Parliament. The Department's aim was to make such incentives of more immediate value to firms performing R&D and to facilitate financing of R&D. In January 1984, the Income Tax Act was amended to provide for a scientific research tax credit program to implement this proposal.

3.36 The program enabled a company to issue to an investor a security that carried a right to a government guaranteed tax credit equivalent to 50 per cent of the funds invested, even though the company had not at the time of issue performed any R&D. To ensure that the R&D was ultimately performed, the company became liable for a refundable tax equivalent to the tax credit.

3.37 For each $2 of R&D performed and for which the company had renounced its right to any related tax benefits, the tax liability was reduced by $1. The tax liability was also reduced for tax credits received by the company for investments made by it under the program.

3.38 We are concerned that the Department of Finance has failed to safeguard public moneys in this program.

3.39 Neither the Department of Finance nor the Department of National Revenue - Taxation was able to provide us with potential program costs to 6 October 1984. We were advised, however, that tax credits issued by companies to investors amounted to approximately $1.6 billion and the offsetting refundable tax liabilities had not yet been paid to National Revenue - Taxation. Although that figure overstates actual program costs to 6 October 1984, we are concerned that the program costs will significantly exceed the amount that Parliament was advised the program would cost.

3.40 Parliament was told that the overall impact of the proposal would be to increase the tax assistance to R&D by some $100 million in the first year. We were told by the Department of Finance that it had estimated internally that annual costs of the program, once the system was in place, would be about $225 million, and the figure of $100 million represents the net cost of all the R&D tax changes. In our opinion, the information presented to Parliament was susceptible to misinterpretation.

3.41 In addition, we were told by National Revenue - Taxation that anomalies in the legislation led the Department of Justice to advise National Revenue - Taxation that it is not clear when payment of the refundable tax must be made.

3.42 To deliver a program such as this through the tax system, complex legislation is required. The legislation is, in effect, the program delivery system. A program of this nature makes taxpayers' funds directly available to a participant, and, in this respect, similar to a program directly funded through the Estimates. We would have expected the Department of Finance to ensure that the legislation included basic procedures to safeguard public moneys.

3.43 The program did not require the investment to be outstanding for a minimum length of time; the investment could be repaid immediately for a prearranged amount. This procedure came to be known as a "quick flip". The amount repaid, plus the tax credit, provided the investor with a quick, no-risk profit.

3.44 In a "quick flip" transaction, a company might issue a security to an investor, providing for each dollar invested a return of 55 cents. This amount, plus the government guaranteed 50-cent tax credit, would give the investor a quick, no-risk profit of 5 cents. The company would retain 45 cents.

3.45 Parliament was told that the program was founded on four principles, two of which are: "incentives should not be used, or set at a level, to promote R&D activities that do not conform to sound business practice"; and, "as much as possible, tax incentives for R&D should be of immediate benefit to firms". We were told by the Department of Finance that the "quick flip" arrangement was clearly envisioned from the outset of the program to make the incentive of immediate benefit to firms.

3.46 Although "quick flips" provided the incentive of immediate benefit, they could be used to promote R&D activities that do not conform to sound business practice. R&D activities that are unprofitable in a business sense could become attractive to investors solely because of the tax treatment. The result might be waste of valuable resources. In our opinion, the information presented to Parliament was also susceptible to misinterpretation.

3.47 The opportunity to obtain a "quick flip" has created a lucrative market for a unique type of government guaranteed security. As a result, most transactions under the program to date have involved "quick flips".

3.48 "Quick flips" have also created problems for National Revenue - Taxation. It became concerned that unless a company had access to additional financing, the net proceeds from a "quick flip" would not be sufficient to finance the level of R&D necessary to ultimately eliminate all its refundable tax liability. This could result in bad debts for the government. Therefore, on 10 July 1984, the Department began issuing assessments for the refundable tax, to be followed by individual contacts by District Officers to determine the status of the tax and any collection action required.

3.49 On 10 October 1984, the Minister of Finance announced a moratorium on "quick flip" transactions. For the duration of the moratorium, only common equity shares complying with certain criteria will be entitled to the tax credit.

3.50 Department of Indian Affairs and Northern Development - Inadequate Accounting for Contributions of $500 Million to Indian Bands

> **Since 1967, this Office has reported to Parliament that controls exercised over contributions to Indian bands are inadequate. Despite recommendations by the Public Accounts Committee, the Department has yet to establish an effective accountability process for these contributions. The level of contributions has grown from $300 million in 1979-80 to over $500 million in 1983-84.**

3.51 The Department of Indian Affairs and Northern Development has for some years been transferring to Indian bands responsibility for managing public funds provided for various band programs.

3.52 The Office has reported to Parliament in 1967, 1977, 1978 and 1980 on the inadequacy of practices followed by the Department in controlling and monitoring public funds administered by Indian bands.

3.53 A condition of the transfer is that the bands provide the Department with yearly audited financial statements, to ensure an adequate accounting for the funds and to provide a basis for departmental monitoring and evaluation of expenditures. More than half of the audit reports on financial statements provided by the bands to the Department during the year were either qualified or expressed a denial of opinion.

3.54 The Standing Committee on Public Accounts, in its Sixth Report dated 23 June 1981, recognized the different needs of bands and recommended that the Department and Treasury Board develop accountability processes appropriate for different funding methods and different means of program delivery, which are more appropriate both for the Indians and the Government.

3.55 The Department has made a submission to Treasury Board on a proposed mechanism of accountability for the use of the funds. Treasury Board has not agreed to this method. In the meantime, the level of contributions to Indian bands has grown from $300 million for 1979-80 to over $500 million for 1983-84.

3.56 Department of Indian Affairs and Northern Development - Questionable Safeguards over the Release of Indian Capital Moneys

> During the year ended 31 March 1984, the Department of Indian Affairs and Northern Development authorized payments of $196 million out of Indian capital moneys to Indian bands. Legal counsel has advised us that certain of these payments may not be permitted under the terms of the Indian Act.

3.57 The Department of Indian Affairs and Northern Development is responsible for managing "Indian moneys", defined as all moneys collected, received or held by Her Majesty for the use and benefit of Indians or bands. The Indian Band Funds are held in the Consolidated Revenue Fund and administered in accordance with the Indian Act. Each of these Funds is divided into two accounts – a capital and a revenue account. Section 64 of the Indian Act provides that the Minister may, with the consent of the council of a band, authorize expenditures from Indian capital moneys for a number of specific purposes.

3.58 During the fiscal year 1983-84, the Department authorized payments of $196 million out of Indian capital moneys. Legal counsel has advised us that, while certain kinds of non-capital expenditures can, by the terms of the Act, lawfully be made out of capital funds, some payments may not. These include operating expenditures for welfare programs, community services, adult education, recreation and work development programs. In those cases where section 64 of the Act presents real difficulties of interpretation, and particularly where large sums (and therefore a large potential Crown liability) are involved, the Department of Justice suggested that such expenditures be approved by the band membership as well as the band council. The Department of Justice further suggested that the Department of Indian Affairs and Northern Development seek a judicial opinion from the courts. These suggestions have not been acted on by the Department.

3.59 According to the Department of Justice, the control of capital moneys, even after they have been transferred to the band councils, remains the responsibility of the

Crown. The Minister would thus be obliged to review periodically the ways in which the approved expenditure plan was being implemented and to make any adjustments in the plan or in its implementation that appeared to be for the benefit of the band.

3.60 Department of Indian Affairs and Northern Development - Reimbursement of Education Costs Totalling $2.6 Million Made Without Parliamentary Authority

> In 1983-84, the Department, without parliamentary authority, made an out-of-court settlement of $2.6 million with a school board in the Province of Saskatchewan for certain education services that are not permitted under the Indian Act.

The Department of Indian Affairs and Northern Development provides education assistance for Indians residing on reserves or Crown lands.

3.61 The Department of Indian Affairs and Northern Development does not have authority under the Indian Act to provide financial assistance to further the education of Indians who do not reside on an Indian reserve or on Crown land. Nevertheless, the Department made an out-of-court settlement of $2.6 million with a school board in the Province of Saskatchewan which had provided education services to Indians not residing on reserves. At the same time, the Department was owed $821,000 by the school board for non-Indians attending Indian schools. The Department sought and received Treasury Board approval for a payment to the school board of $1.8 million; that is, the $2.6 million it owed, less the $821,000 owed by the school board. The Department then charged $1.8 million to expenditure, but sought authority through Supplementary Estimates for only $101,000 of this amount.

3.62 Because the Indian Act excludes Indians not residing on reserves from being eligible for education assistance, the Department should have sought authority from Parliament for the full amount of $2.6 million. Further, the Department should have credited the $821,000 to the Consolidated Revenue Fund.

3.63 Department of Indian Affairs and Northern Development - Education Costs Paid Twice

> Under the terms of tuition agreements with three school boards in the Province of Ontario, the Department had to make payments of over $600,000 for tuition costs for children of several Indian bands. The Department had already paid for this tuition through contributions to the Indian bands.

3.64 The Department of Indian Affairs and Northern Development entered into tuition agreements with three school boards in the Province of Ontario for the education of children from several Indian bands. The Department subsequently entered into contribution agreements with these bands and, according to the agreements, provided the bands with funds for the tuition so they could administer them, dealing directly with the school boards.

3.65 The bands received the tuition services but either failed to make the payments to the school boards or made only partial payments. Because the Department had signed the tuition agreements with the boards, it had a contractual liability to pay for the tuition services. In spite of the Department having previously provided funds to the bands, it had to make payments of over $600,000, including interest charges, to the school boards.

3.66 Department of Indian Affairs and Northern Development - Loss Due to Unauthorized Issue of Timber Licence

> The Department issued a timber licence to cut trees on a reserve; the licence was subsequently declared invalid. As a result, the Department had to make a $1.2 million out-of-court settlement with the company that was deprived of the right to cut the trees.

3.67 The Department of Indian Affairs and Northern Development issued a timber licence to cut trees on a reserve for the period October 1975 to April 1977 and renewed the licence from May 1977 to April 1978. Because the initial licence was longer than permitted by the Indian Timber Regulations, and the renewal was therefore also invalid, the Indian band asked the licence holder to vacate the reserve.

3.68 A court of appeal upheld the band's claim that the licence was invalid and the renewal was also not properly issued. Because of its non-compliance with the Regulations, the Department had to make a settlement with the company that was deprived of the timbering rights. This resulted in an out-of-court settlement in May 1984 for $1.2 million. An amount of $574,926 was charged to the accounts in 1983-84.

3.69 Department of Regional Industrial Expansion - Deficiencies in Purchase and Sale of LRC Trains

> In July 1982, under the terms of a guaranteed purchase agreement, the Department of Industry, Trade and Commerce purchased two trains from a Canadian manufacturer. The Department paid the maximum guaranteed price of $9 million despite the fact that a major condition of the agreement was not complied with. Two years later, in 1984, the Department sold the trains to VIA Rail for one dollar. The trains have been out of service since May 1982.

3.70 In April 1984, the Department of Regional Industrial Expansion (DRIE) transferred ownership of two Light Rapid Comfortable (LRC) trains to VIA Rail for the sum of one dollar.

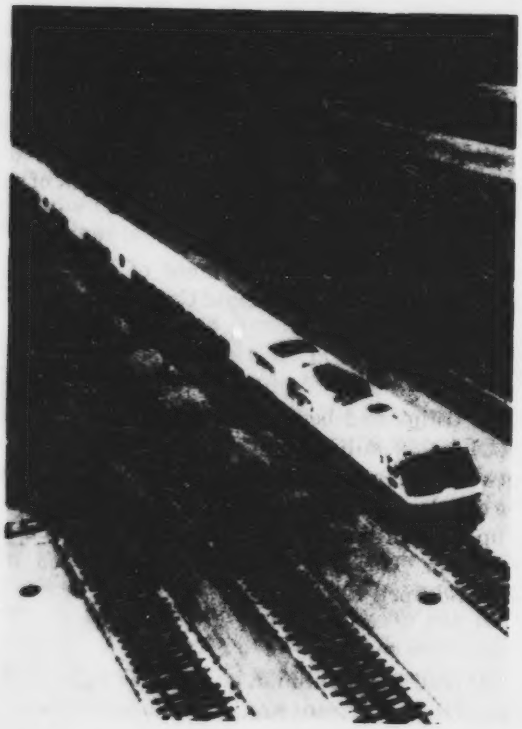
3.71 The trains had been purchased by the Department of Industry, Trade and Commerce (ITC) for $9 million in July 1982. The purchase was made as a result of an agreement between ITC and a manufacturing company. The purpose of the agreement was to assist in the development and marketing of the LRC concept. Under the agreement, ITC agreed to pay up to $9 million for the trains if a United States railway declined to exercise its option to buy them. The U.S. railway had operated the trains under lease between November 1980 and April 1982.

3.72 ITC paid the maximum guaranteed price of $9 million despite the fact that a major condition of the agreement was not complied with.

3.73 The agreement required that the trains were to be returned in good operating condition, normal wear and tear excepted. However, a July 1982 deficiency list, prepared by outside consultants, indicated many repairs were required. In spite of this deficiency list, ITC certified on 23 July 1982 that the trains were in good condition and authorized the $9 million payment.

3.74 Under a further agreement dated 18 January 1984, the company agreed to carry out the repairs noted in the deficiency list. These repairs should have been completed before payment of the $9 million in July 1982 to acquire the trains.

3.75 Under the purchase agreement, $500,000 was deposited in escrow by the company for its use in marketing the trains. No claim on these funds for marketing was ever made by the company. The agreement also stipulated that these funds were to be paid to the Crown if the trains were not sold within 18 months of their purchase by ITC; that is, January 1984. This date was subsequently extended to April 1984. As a result of this extension and the one dollar transfer of ownership on 19 April 1984, the Crown relinquished the opportunity to be paid $500,000.



One of two trains purchased by the Crown for $9 million.

3.76 The trains were taken out of revenue service in May 1982. At the time of our review in August 1984, they were in storage and could still not be used in their present condition.

3.77 Department of Transport - Annual Earnings Retained by Seven Harbour Commissions Without the Minister's Authority as Required by Parliament

> **At 31 December 1983, seven Harbour Commissions had retained a total of $79 million in revenues in excess of expenditures without the Minister of Transport's explicit approval, required by law. The Department of Transport is**

> **currently taking steps to strengthen the financial accountability of the Commissions to the Minister.**

3.78 Section 15(2) of The Harbour Commissions Act requires that the Commissions incorporated under the Act remit to the Receiver General revenues in excess of expenditures at the end of each fiscal year. These Commissions are permitted by the Act to retain all or a portion of these revenues for their future capital or operating requirements, but only with the specific authorization of the Minister.

3.79 At 31 December 1983, the seven Commissions established under the Act had retained in total some $79 million in revenues in excess of expenditures. The financial statements of these Commissions for 1983 indicate that, in practice, the earnings have been retained for the ongoing capital or operating requirements of the respective Commissions. The Department conducts an annual review of the Commissions' activities. However, we found the analysis of the Commissions' annual earnings insufficient for determining whether any portion of the earnings should be considered for payment to the Receiver General. There was no evidence that the Department had sought a decision from the Minister on the annual retention of any surplus earnings by the Commissions.

3.80 Departmental officials now recognize the need for formalizing the necessary approvals. They plan to draw the matter to the attention of the Minister, with a request that the Minister specifically authorize any funds allocated by a Commission for further development. Excess funds, if any, as defined in section 15(2)of the Act, would then be returned by the Commission to the Receiver General. We believe these steps will strengthen the accountability of the Commissions to the Minister. We propose to follow up the final resolution of this matter.

3.81 Department of Transport - Excess Funds of $74 Million Provided to VIA Rail

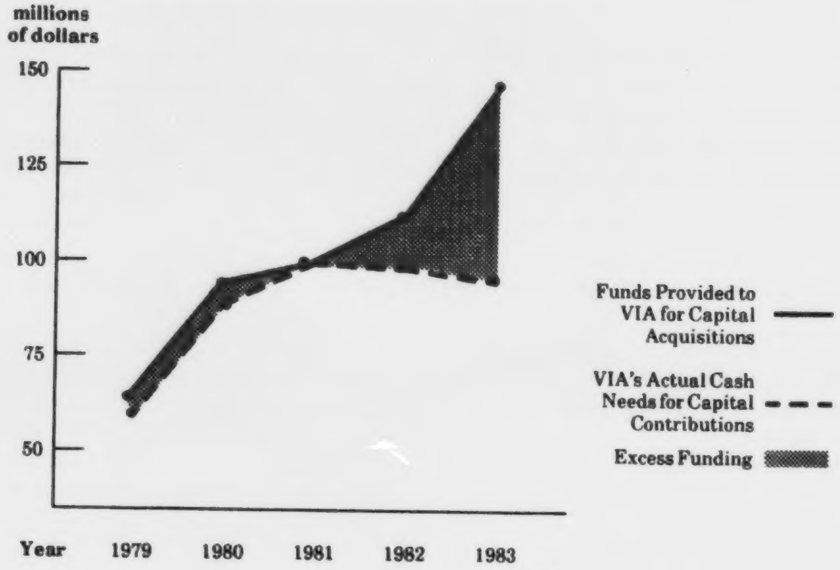
> **Last year, we reported that there was an urgent need for the Government to clarify the terms and conditions that govern the existing arrangements for subsidizing VIA Rail and to assess the options for providing VIA Rail with funds to meet its normal working capital requirements. This issue is still not resolved, and the amount of excess funds provided to VIA Rail increased from $24 million in 1982 to $74 million in 1983.**

3.82 VIA Rail Canada Inc. received $517 million from the Consolidated Revenue Fund to finance approved capital acquisitions during the first five years of the Railway Passenger Program. The terms and conditions for the provision of capital funds state that "the maximum payment to VIA Rail is limited only by the lesser of the level of capital expenditures approved annually by the Governor in Council or the actual cash needs of VIA Rail for capital contributions." In our 1983 Report, paragraph 17.14, we pointed out that at 31 December 1982 VIA Rail had requested and received at least $24 million from Canada for capital expenditures over and above its actual cash needs for capital contributions.

Department of Transport officials estimate that this amount has increased to some $74 million as of 31 December 1983. These excess funds (see Exhibit 3.1) overstate the reported cost of the Surface Transportation Program in the years they were provided to VIA Rail.

Exhibit 3.1

EXCESS FUNDS PROVIDED TO VIA RAIL
1979-83



3.83 The terms and conditions under which VIA Rail is provided funds indicate that excess funds are to be refunded upon written notice from the Minister of Transport to VIA Rail requesting such repayment. Departmental officials have raised the issue of excess funding several times over the past two years with VIA Rail. The Department also informed us that VIA Rail is using the funds in question, without authorization, to augment its working capital. The Department maintains that this use is not consistent with the governing authority under which VIA Rail was provided funds for capital acquisitions.

3.84 The need to recover all excess funds in VIA Rail's control has now been clearly recognized. At the end of July 1984, $43 million in 1984-85 capital funding requested by VIA Rail has already been withheld by the Department. We were informed by the Department that the total amount of excess funds currently outstanding will be established very shortly. Full recovery is anticipated by the end of this calendar year, and the amount recovered will be credited to the Consolidated Revenue Fund as a refund of previous years' expenditure.

3.85 Further, discussions with VIA Rail are in progress on the question of expanding the scope of the audit of VIA Rail's financial and operating results. The Department wants to enhance its monthly review of VIA Rail's actual performance against approved budgets. These steps should prevent future unnecessary payments in advance or in excess of need.

3.86 Department of Transport - $46.8 Million Double Payments Made to Canadian National Railways in 1979 and 1980 Not Returned to Consolidated Revenue Fund

> No action has been taken to recover $46.8 million [illegible] payments to CN, a matter we first reported to Parliament in 1981.

3.87 In paragraph 15.6 of our 1981 Report, we first reported that Canadian National Railways had received double benefits from the Government as a result of the Department of Transport's failure to consider fully the financial implications of changes in legislation that came into force in 1978. In our 1983 Report, paragraph 17.85, we stated that the Department had determined that the amount of the double payments to CN was $46.8 million. We also pointed out, in paragraph 17.86, that parliamentary approval would be required should the Department decide to include this amount in its outstanding consolidated loan to CN rather than recovering the amount of the double payments.

3.88 The double payments were made during 1979 and 1980 and recorded as government expenditures for those years. The interest benefit to CN for the continued use of this $46.8 million, which it was not entitled to receive, totalled about $20 million to 31 March 1984.

3.89 Departmental officials informed us in August 1984 that the matter has been raised with successive Ministers of Transport. No action has been taken by the Department to obtain parliamentary approval for extending its loan to CN or to recover the amount of the double payments, pending receipt of instructions from the Minister. In its financial statements, CN continues to show the amount owing to Canada as a long-term debt.

3.90 Exchange Fund Account - Valuation of Gold and Accounting for the Realized Gains on Sales of Gold

> Recent amendments to legislation were made to provide explicit authority for accounting policies followed by the Exchange Fund Account. Until that time, the lack of such authority had caused us to qualify our audit report on the financial statements of the Account.

3.91 The Exchange Fund Account is an account in the name of the Minister of Finance, governed by the Currency Act and administered by the Bank of Canada, to aid in controlling and protecting the external value of the Canadian dollar.

Gold in the weighing room, Bank of Canada.

3.92 Our audit report to the Minister of Finance for the year ended 31 December 1983 was qualified with respect to the accounting policies being followed by the Account. In our opinion, the accounting policies for the valuation of gold and accounting for the realized gains on sales of gold were not in accordance with section 16 of the Currency and Exchange Act (now titled the Currency Act).

3.93 Amendments to the Act to provide explicit authority for the accounting policies being followed by the Account were passed by the House of Commons on 23 May 1984 and received Royal Assent on 7 June 1984.

3.94 Questionable Compensation Payments Involving Management Staff

> **Two departments made cash compensation payments totalling $163,806 to five members of the Management category for accumulated vacation and furlough leave. Such payments were not permitted under published compensation policy for this category.**

3.95 In the fiscal year ended 31 March 1984, the Canadian Radio-television and Telecommunications Commission (CRTC) and the Solicitor General of Canada paid cash compensation of $163,806 for accumulated vacation and furlough leave to senior management staff. We noted four cases in the CRTC and one in the Solicitor General. The amounts paid ranged from $12,130 to $77,966. Neither of these departments was able to provide us with appropriate documentation authorizing the payments.

3.96 According to the Personnel Management Manual which describes the terms and conditions of employment for public service staff in the Management category, conversion of leave credits to cash is permitted only on termination of employment. This did not apply in any of these cases.

3.97 We raised the question of the legality of such payments with the Treasury Board Secretariat (TBS), which is responsible for administering compensation policy affecting this category. TBS advised us that the payments were legal, notwithstanding what was contained in the Personnel Management Manual. TBS indicated that the payments were permitted under the terms of a non-promulgated Treasury Board decision dating back to January 1982. TBS had not promulgated the decision because a number of issues still had to be resolved. TBS indicated that the subsequent enactment of the Public Sector Compensation Restraint Act was another reason for not making the decision known.

3.98 Although it was never promulgated, the existence of the January 1982 Treasury Board decision became known to some departments. Although the fact that the decision had not been announced was a clear sign that payments should not be made, the CRTC proceeded to make them, acting on unofficial information about the Treasury Board decision. We have been advised by the Solicitor General of Canada that it made the payment after confirming orally with TBS that there was a Treasury Board decision on the matter. TBS indicated to us that in every instance departmental staff who enquired about these payments were advised that there was no instruction permitting them.

3.99 In our opinion, these were questionable compensation payments to members of the Management category. We believe the CRTC and the Solicitor General of Canada should have sought advice formally and should not have made these payments unless officially authorized to do so by TBS directive.

Report Under Section 11 of the Auditor General Act on our Continuing Review of the Oil Pricing and Compensation Programs

3.100 As directed by the Governor in Council, the Auditor General has undertaken a continuing inquiry into the administration of expenditures of the Oil Import Compensation Program, beginning with the 1973-74 fiscal year. From 1978 to 1982, the inquiry also included an audit of the Petroleum Compensation Revolving Fund. Since 1982, it has covered the administration of the revenues and expenditures of the Petroleum

Compensation Accounting process, of which the Oil Import Compensation Program is now an element.

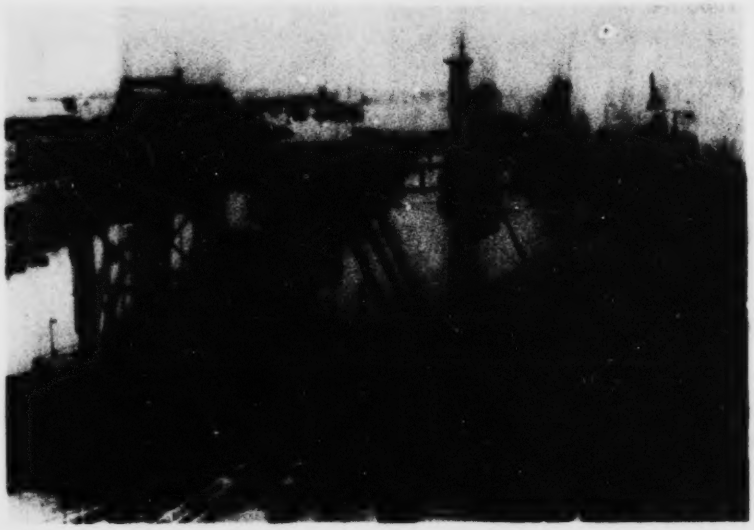
3.101 Sections 65.11 to 65.19 of the Energy Administration Act provide authority for imposing a Petroleum Compensation Charge on domestic and foreign petroleum including foreign petroleum products for processing, consumption, sale or other use in Canada. Sections 71 to 76 of the Act provide authority for paying compensation to importers of foreign crude oil, producers of new conventional oil, special old oil and synthetic oil, and to companies transferring crude oil from Montreal to eastern Canada and when exchanging Canadian crude for foreign crude oil. Under section 77 of the Act, these revenues and expenditures are brought together as part of the Petroleum Compensation Accounting process. Effective 1 January 1984, a designated portion of the Oil Export Charge revenues was added to the process.

Petroleum Compensation Accounting Transactions

3.102 The following is a summary of Petroleum Compensation Accounting for 1983-84, with comparative figures for 1982-83:

	1983-84	**1982-83**
	(millions of dollars)	
Revenues		
Petroleum Compensation Charge	$ 1,748	$ 3,031
Petroleum Export Charge	2	-
	1,750	3,031
Expenditures		
New Oil Reference Price Program	1,034	454
Oil Import Compensation Program	541	1,398
Synthetic Oil Supplement Program	498	916
Special Old Oil Price Program	121	190
Domestic Transfers Compensation Program	38	37
Crude Oil Exchange Program	1	1
	2,233	2,996
Surplus (Deficit)	$ (483)	$ 35

3.103 The 1981 Memorandum of Agreement with Alberta on Energy Pricing and Taxation commits the federal government to leave no revenue in excess of the amount required for expenditures over the period 1981-86. This is to be achieved through periodic adjustment to the Petroleum Compensation Charge rate. The cumulative deficit at 31 March 1984 was $387 million. The substantial decrease in Petroleum Compensation Charge revenues from 1982-83 to 1983-84 was the result of a reduction in the rate on 1 January 1983.



Foreign crude oil eligible for import compensation being discharged at Dartmouth, Nova Scotia.

3.104 Effective 1 January 1984, all Oil Export Charges collected in lieu of a compensation payback on oil exports made from provinces east of Ontario were designated to be a portion of Petroleum Compensation Accounting. This designation was by Governor in Council under section 77(2) of the Energy Administration Act.

3.105 Rates of compensation or supplement applicable to the four major expenditure categories declined from 1982-83 to 1983-84 as a result of the decreasing spread between international and Canadian oil prices. In the Oil Import Compensation Program, declining rates, combined with declining import volume, resulted in reduced expenditures. Under the Synthetic Oil Supplement Program, declining rates reduced expenditures, although the volumes of oil were fairly stable over the two years. However, volumes of oil subject to the New Oil Reference Price Program increased significantly. This more than offset the effect of the decline in the supplement rates and resulted in an overall increase in expenditures.

3.106 For the Special Old Oil Price Program, there were only nine months' expenditures in 1982-83, since the program began on 1 July 1982. While supplement rates declined through to the early part of 1983-84, Special Old Oil became eligible to receive the

higher New Oil Reference Price supplement rates as of 1 July 1983. Because New Oil and Special Old Oil after 1 July 1983 had the same price, Alberta did not differentiate these oil categories in its applications to receive supplement, thus payments are included under New Oil Reference Price Program Expenditures.

3.107 There were no significant changes in the volume of expenditures under the Domestic Transfers Compensation Program or the Crude Oil Exchange Program between 1982-83 and 1983-84.

Audit Scope

3.108 We examined the revenue and expenditure transactions of the Petroleum Compensation Accounting process in accordance with generally accepted auditing standards and, accordingly, we included such tests and other procedures as we considered necessary in the circumstances.

Conclusion - Financial Transactions

3.109 In our opinion, revenues and payments for the fiscal year ended 31 March 1984 have been properly processed within the accounts of Canada and are in conformity with applicable legislation and regulations.

Audit Observations

3.110 **Program administration audits.** The Auditor General of Alberta has issued an audit report for the year ended 31 December 1982 on his examination of the receipts and disbursements, amounting to $294 million, respecting the New Oil Reference Price and Special Old Oil Price Programs as defined in the Memorandum of Agreement between the Government of Canada and the Province of Alberta. His audit for the year ended 31 December 1983, covering receipts and disbursements involving $666 million, was in progress at the time of our audit of the Petroleum Compensation process for the year ended 31 March 1984. This audit includes certain specified objectives concerning the administration of the New Oil Reference Price and Special Old Oil Price as arranged with the Department of Energy, Mines and Resources of the Government of Canada.

3.111 For the Programs administered by the Provinces of British Columbia, Saskatchewan, Manitoba and Ontario, staff of Energy, Mines and Resources have carried out program audits for periods up to 31 March 1983.

3.112 These audits are in accordance with the Memoranda of Agreement with the participating provinces wherein they will provide access to the accounts of the program for purposes of audit and review by the Government of Canada.

Drilling a new oil well in Northern Alberta.

3.113 At the time of our audit for the year ended 31 March 1984, no material matters had been identified.

3.114 **Unpaid levies.** A total of $26.4 million in unpaid levies is owed to the Crown by two levy payers in financial difficulties ($26.2 million is owed by one company). Departmental officials are monitoring this situation.

Change in Audit Mandate

3.115 In December 1983, because of the significant changes in the Oil Import Compensation Program, the Auditor General requested the Governor in Council to review the instructions for the audit of the program. The matter was referred to the Department of Energy, Mines and Resources. Following discussions with us, and because of the increased audit mandate given in the Auditor General Act 1977 and the establishment of internal program audit systems, the Department of Energy, Mines and Resources has agreed to recommend that the Governor in Council can now withdraw the previous direction to the Auditor General to report annually on the Oil Import Compensation Program.

3.116 Until we receive instructions from the Governor in Council to discontinue our inquiry, this Office will report annually as directed.

1984 IMPAC Progress Review

Introduction

3.117 The progress of IMPAC – the effort by the Office of the Comptroller General (OCG) to bring about improvements in management practices and controls – is monitored by our Office in response to a request from the Public Accounts Committee. Our review is designed to provide Parliament with an independent, ongoing review of the status of the IMPAC process, including implementation of individual departmental action plans.

3.118 These plans cover such key areas as developing or improving departmental planning systems, financial management and controls, management and operational information systems, and developing program evaluation, internal audit and other functions.

Scope of Review

3.119 Our 1984 review included all departments and agencies surveyed by the OCG prior to 31 March 1982 as part of the IMPAC process. It focused on the status of action plans and on departmental progress in implementing action plans to 31 March 1984.

3.120 Information for our review was provided by the departmental IMPAC coordinators and the liaison officers of the OCG; we did not verify this information.

3.121 We integrated this IMPAC review with our comprehensive audits of departments and agencies. Consequently, chapters reporting on the comprehensive audits, as well as Chapter 5, our government-wide study of the internal audit function, provide audit observations and recommendations, where reasonable and appropriate, on management practices in the key areas covered by departmental IMPAC action plans.

Status of Action Plans

3.122 In total, 31 departments and agencies, which account for about 85 per cent of government expenditure, excluding the public debt, were surveyed in the IMPAC process.

Exhibit 3.2

STATUS OF ACTION PLANS - 31 March 1984

	DEPARTMENTS AND AGENCIES[1] (With Endorsed Action Plan)	ACTION PLAN DATES			ACTION PLAN BUDGETS AND COSTS	
		Original Endorsement Date	Expected (Actual) Completion Date	Action Plan Status[2]	Total Budget ($ millions)	Costs to-date ($ millions)
1.	National Health and Welfare	November 1979	March 1985	R, Ongoing	13.4	8.8
2.	RCMP	December 1979	April 1985	R, Ongoing	2.3	2.0
3.	DSS-Services	December 1979	(June 1983)	Graduated	3.0	1.6
4.	Energy, Mines and Resources	December 1979	March 1984	R, Ongoing	1.7	2.5
5.	Employment and Immigration[3]	February 1980	(July 1984)	Graduated	None	61.3
6.	Agriculture	March 1980	April 1986	Ongoing	17.1	10.5
7.	Public Works	April 1980	April 1986	R, Ongoing	45.8	22.5
8.	Environment	September 1980	April 1985	R, Ongoing	12.3	9.2
9.	CIDA	December 1980	December 1985	Ongoing	21.1	15.7
10.	Veterans Affairs	December 1980	March 1986	Ongoing	18.8	17.8
11.	Customs and Excise	January 1981	December 1987	Ongoing	14.0	9.4
12.	DSS-Supply	February 1981	(March 1984)	Graduated	1.5	1.3
13.	Correctional Service	March 1981	April 1984	Ongoing	7.8	8.2
14.	Consumer and Corp. Affairs	March 1981	March 1985	R, Ongoing	1.5	1.3
15.	Canadian Transport Commission	March 1981	March 1985	R, Ongoing	6.2	4.1
16.	National Revenue-Taxation	March 1981	(April 1982)	Graduated	1.7	1.9
17.	Regional Economic Expansion	March 1981	January 1982	Terminated	2.3	0.6
18.	Secretary of State	May 1981	December 1984	R, Ongoing	2.4	1.9
19.	National Museums	May 1981	Open-ended	R, Ongoing	3.3	1.5
20.	Industry, Trade and Commerce	June 1981	January 1982	Terminated	1.7	0.3
21.	Labour	June 1981	June 1985	Ongoing	None	Unknown
22.	Justice	July 1981	March 1985	Ongoing	3.6	2.0
23.	Indian Affairs & North. Dev.	July 1981	April 1985	R, Ongoing	17.2	13.7
24.	Transport	November 1981	February 1987	Ongoing	31.3	15.5
25.	Statistics Canada	April 1982	June 1985	Ongoing	4.8	3.1
26.	External Affairs	May 1982	March 1988	R, Ongoing	27.5	7.4
27.	Fisheries and Oceans	May 1983	June 1985	Ongoing	4.5	2.8
28.	Regional Industrial Expansion	July 1983	April 1985	Ongoing	6.6	5.1
				TOTAL	$273.4	$232.0

Footnotes:

1. IMPAC surveys were conducted for an additional three departments, although no endorsed action plans were developed: Post Office Corporation, Treasury Board Secretariat and National Defence are classified by the OCG as disengaged from the IMPAC process.

2. The letter 'R' indicates that the departmental action plan has been revised, one or more times, since it was first endorsed by the OCG.

3. The cost figure includes expenditures prior to IMPAC initiatives, development costs, and ongoing operational costs.

3.123 Of the original 31 departments, 3 have disengaged from the IMPAC process. The Treasury Board Secretariat stated in a letter to the OCG in 1983 that its management practices and controls had been improved to such an extent that further OCG involvement was no longer required. In the case of the Department of National Defence, the OCG rated its management systems as satisfactory and hence did not require the preparation of an action plan. The Post Office became disengaged when it became a Crown corporation and thus outside the OCG's IMPAC mandate.

3.124 Exhibit 3.2 shows the status of the 28 departmental action plans at 31 March 1984 in terms of their endorsement by the OCG; that is, approval of their contents, costs and implementation strategy. The exhibit also shows the expected completion dates as well as budget and cost data.

3.125 Four departments – DSS-Services, DSS-Supply, National Revenue - Taxation, and Employment and Immigration – have graduated from the IMPAC process. This term is used by the OCG to indicate that the completed action plan has been reviewed, validated, judged satisfactory and signed off. Two others, the Department of Regional Economic Expansion and the Department of Industry, Trade and Commerce, had their implementation terminated in 1982 as a result of government reorganization. Arising out of this reorganization was the Department of Regional Industrial Expansion for which a new IMPAC action plan was prepared.

3.126 Progress in implementing action plans in the remaining 22 departments and agencies is shown in Exhibit 3.3, which also shows the change since last year's report. Most action plans have undergone some degree of revision in content or timing. However, 11 of the 22 plans had major revisions and were re-endorsed by the OCG.

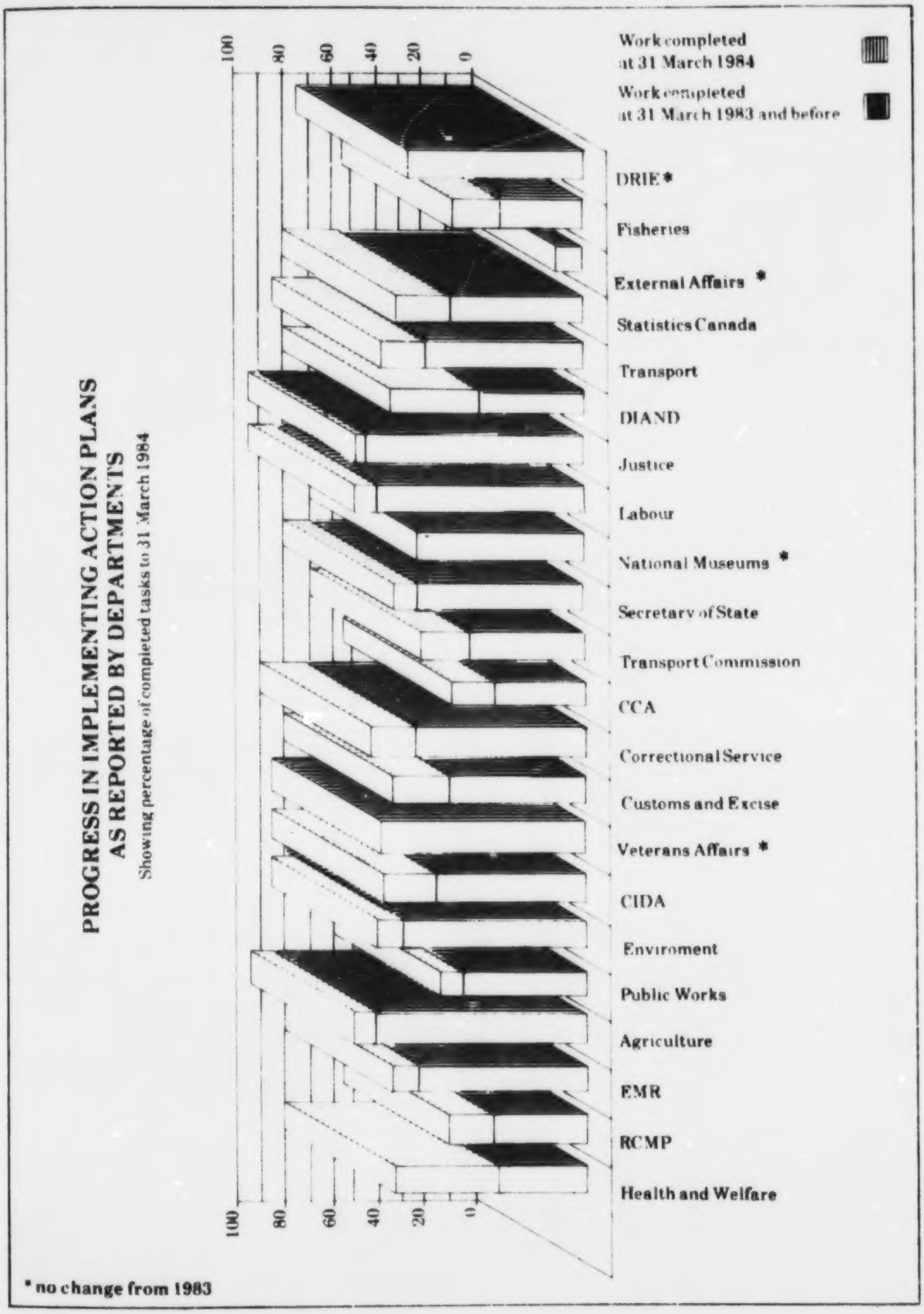
3.127 Exhibit 3.2 also shows the costs for implementing action plans as estimated by all 28 IMPAC departments. Committed costs for IMPAC, as reported by the departments, were $273 million. About $232 million had been spent at 31 March 1984. Because the cost figures were not compiled by departments in a uniform manner, we could not assess their accuracy.

3.128 As of 31 March 1984, the OCG estimated benefits of $144.9 million annually, recurring, and $19.1 million, non-recurring, as a result of the IMPAC process. Deputy heads in departments and agencies have formally committed themselves to a further $75.1 million. Confirmation of all benefits should be included in the evaluation of the IMPAC process that has been commissioned by the OCG.

Progress in Implementing Action Plans

3.129 **Departmental progress.** Exhibit 3.3 shows the overall rate of progress achieved by the 22 departments currently working on their action plans.

Exhibit 3.3



PROGRESS IN IMPLEMENTING ACTION PLANS AS REPORTED BY DEPARTMENTS

Showing percentage of completed tasks to 31 March 1984

* no change from 1983

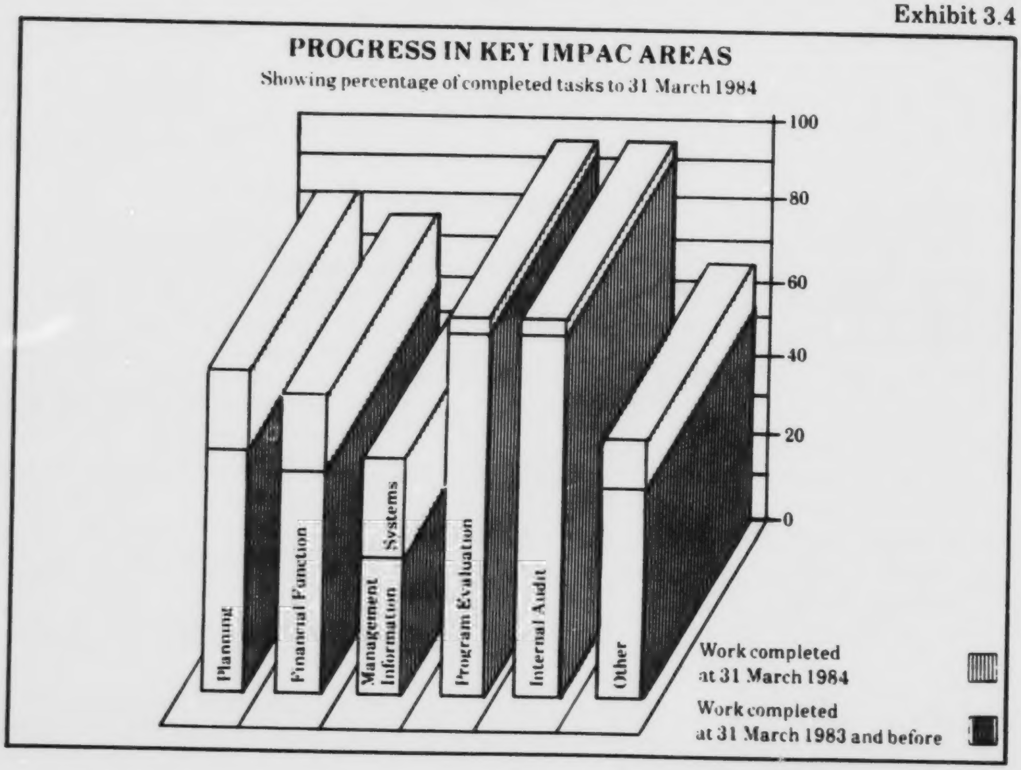
3.130 Progress is summarized according to information supplied by departments. An indicator was selected that permitted measurement of progress made. This indicator, shown in Exhibit 3.3, is the number of completed tasks as a percentage of the total number of tasks in a particular action plan. A task in this context means a project activity, with clearly defined starting and completion points, undertaken to improve some aspect of management procedures and controls. Exhibit 3.3 also shows the percentage change from last year.

3.131 Exhibit 3.3 shows only the progress made by each of the 22 departments in implementing its action plan, according to a common indicator. Comparisons between departments are not possible because of the unique nature of each action plan in terms of content as well as complexity and size. For example, the plan for National Revenue - Taxation contains 10 projects, while plans for Transport Canada and External Affairs contain 87 and 121 projects respectively.

Progress in Key IMPAC Areas

3.132 Exhibit 3.4 shows the progress in implementing action plans for the six key IMPAC functional areas by aggregating the information for the 28 departments whose project work is either completed or is still ongoing.

Exhibit 3.4



PROGRESS IN KEY IMPAC AREAS

Showing percentage of completed tasks to 31 March 1984

3.133 This information, provided by departments and the OCG, shows that departments have made notable overall progress during the past four years in establishing and improving the infrastructure for the internal audit, program evaluation, planning and financial management functions. Reasonable progress has been made in the complex process of establishing management information systems, particularly in the past year.

Conclusion

3.134 While progress in implementing action plans has varied considerably among departments and agencies, completed tasks as a percentage of total planned IMPAC tasks increased from about 65 per cent at the end of 1982-83 to about 75 per cent at 31 March 1984.

3.135 To date, no assessment has been made of the extent to which planned improvements in management practices and controls have been implemented. Neither has an assessment been made of the effectiveness of the measures in achieving objectives and goals. There has been no evaluation of the actual effects of IMPAC in making departmental operations in the federal government more economical, efficient and effective.

3.136 In 1982, the Office of the Comptroller General gave an undertaking to the Public Accounts Committee that it would arrange for such an evaluation. In 1984, the OCG selected consultants to perform an evaluation, and the work is currently under way.

Major Capital Projects

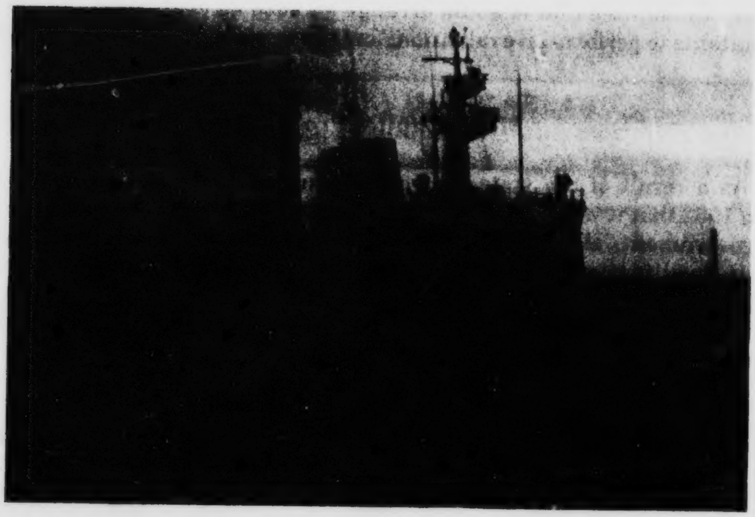
3.137 As a result of the statement of the Auditor General to the Public Accounts Committee in 1982 that it was the intention to examine on a regular basis capital projects of the federal government, this Office has begun to develop the methodology needed to standardize its investigation of these projects. During this year, we have carried out audits of several major capital projects, including highway, building and ship construction. The acquisition of Coast Guard ships is one of these projects. Other cases are in the chapters related to specific departments.

Canadian Coast Guard - Deficiencies in Vessel Design and Acquisition Procedures

3.138 The Canadian Coast Guard's Fleet Investment Plan sets out capital expenditures of approximately $3 billion over a 30-year period to replace major vessels of the Coast Guard Fleet, including icebreakers and navigational aid tenders. In addition, the Search and Rescue acquisition program involves expenditures of $10 million a year. We audited project management and acquisition procedures for three major capital projects – the Class 1100 Navaids tender/light icebreaker design contract; the "R" Class icebreaker *Des Groseilliers*; and the Class 400 Search and Rescue Cutters. The Department of Transport manages these projects and the Department of Supply and Services manages the contracts.

3.139 We found that, although the design and construction of the vessels were adequate, in two of the three projects there were deficiencies in both the design and procurement processes that affected their life cycle costs and construction quality. In view of the substantial capital outlay planned, it is important that future ship acquisitions be accomplished with due regard for economy.

3.140 The *Des Groseilliers*, delivered to the Coast Guard in 1982 at a cost of $62 million, was built using propulsion systems produced in Canada, which, because of their design, require a high level of maintenance. Although the Coast Guard recognized that this choice would involve high maintenance costs, it accepted the engines because they were the only Canadian engines available, and it did not make a life cycle cost comparison of other options. The propulsion system accounts for approximately 15 per cent of the total cost of the vessel. In our view, in future, the long-term financial costs of satisfying particular Canadian content policy requirements should be presented to the appropriate ministers.



Canadian Coast Guard heavy icebreaker Des Groseilliers.

3.141 Also, the manning level of the *Des Groseilliers* was established without the use of modern method study techniques. The resulting level is much higher than the level for commercial vessels with similar profiles. We were informed that this was because of the specific tasks performed by the *Des Groseilliers*. However, since the Coast Guard did not formally determine the most cost-effective method of operation, it does not know whether the vessel's crew size is the most appropriate. The Coast Guard should ensure that its future ship designs reflect the most cost-effective crew sizes, and should use the most modern study techniques in developing crew sizes.

3.142 For the four Class 400 Search and Rescue Cutters, the construction contracts did not include clearly defined quality assurance standards against which Department of Supply and Services (DSS) inspectors could judge completed work. For example, specific standards for aluminum hull welding were omitted. As a result of this, two years after delivery, the vessels' hulls were found to be poorly welded. The Department of Transport had to spend $270,000 for special repairs to fix the defects.

3.143 Also, DSS did not evaluate the capability of the ship construction yard to do the specific work contracted for before assigning the construction contract. It was subsequently discovered that the yard was not qualified to do the aluminum welding work.

3.144 In our view, these problems could have been avoided had appropriate quality assurance standards been clearly defined by the Department of Transport and had an evaluation of the shipyard facilities updated by the Department of Supply and Services prior to awarding the contract.

3.145 The Department of Transport acknowledges that modern study techniques could lead to possible reductions in crew size, but states that because the *Des Groseilliers* project was implemented under objectives of a government-wide economic stimulation program, it was not possible to use these techniques because of time constraints. We were also informed by the Department that contract documentation for the proposed new 800 series of vessels incorporates requirements for quality assurance. We propose to review the adequacy of quality assurance programs in future.

REVIEW OF CASH MANAGEMENT

REVIEW OF CASH MANAGEMENT

Table of Contents

	Paragraph	Page
Overview	4.1	4–1
Audit Scope	4.6	4–1
Observations and Recommendations		
Management of the Function	4.9	4–2
Cost of Existing Banking Arrangements	4.15	4–4
Renegotiation of Financial Arrangements	4.25	4–6
Billing, Collection, Deposit and Payment Practices	4.26	4–6

4

REVIEW OF CASH MANAGEMENT

Overview

4.1 Cash flowing into and out of the government's bank account, the Consolidated Revenue Fund (CRF), totals approximately $500 billion annually. The size of this cash flow makes good cash management a necessity in the federal government. We have defined cash management as those activities relating to the billing, collection and deposit of moneys owed to the government, the payment of moneys and the use of government cash balances. Cash is defined as being those moneys flowing into, out of and within the Consolidated Revenue Fund.

4.2 The Department of Finance is responsible for ensuring that the government has sufficient cash on deposit to meet its obligations, including the raising of money through borrowings. The Department of Finance is not, however, involved in day-to-day cash management activities. Responsibilities for managing these activities are widely shared within the federal government.

4.3 The Office of the Comptroller General is responsible for the development and ongoing evaluation of the government's financial management systems and practices and for monitoring of compliance with them. It also issues guidelines and directives relating to these systems and practices. Within this framework, the Receiver General is responsible for developing and maintaining the systems for actually depositing public moneys to and making payments out of the CRF and issuing directives relating to these operations. Individual departments and agencies are responsible for the billing and collection of funds and for the timing of deposits and payments. The Bank of Canada, in addition to being responsible for monetary policy, is the government's banker.

4.4 As in the private sector, government cash management has assumed greater financial importance as interest rates have risen and cash flows have become larger. Because of the heightened importance of good cash management, both this Office and the Lambert Commission have encouraged the government to improve its cash management practices.

4.5 In May 1982, the government entered into negotiations with the financial institutions to revise its banking arrangements. These negotiations are still underway and are focusing on the unbundling of services received, the introduction of fees per unit of service rendered such as cheque processed, and the interest rate on cash balances.

Audit Scope

4.6 Our government-wide review of cash management concentrated on the management of the function, the cost of existing banking arrangements with financial institutions, including revenue earned on cash balances, and deposit and payment practices. We conducted only a limited review of billing and collection practices in 10 departments and agencies since future comprehensive audits of the major revenue producing departments will include a detailed examination of these practices. We tried to identify areas where significant dollar savings could be realized.

4.7 Organizationally, our review focused primarily on the Department of Finance, the Office of the Comptroller General, and the operations of the Receiver General. In addition, we reviewed certain departmental operations, such as billing, collection, deposit and payment practices, as they pertained to cash management. We also examined the functions of public debt and foreign exchange stabilization management to understand their relationship to cash management. Both are closely linked to monetary and fiscal policy issues that were outside the scope of this audit. Although we are not the auditors of the Bank of Canada, we discussed with Bank officials its role as the government's banker. We also discussed with Treasury Board Secretariat officials its role with respect to cash management. We did not review cash management practices in Crown corporations, but we did examine the timing of payments to these organizations.

4.8 There are many important aspects to the relationship between the federal government and financial institutions, particularly the chartered banks. While our audit concentrated on the role of the financial institutions as providers of banking services to the government, we reviewed other aspects of the relationship, such as the primary reserve requirements, corporate taxation provisions and the issue and redemption of public debt, to better understand the broader relationship between the government and the financial institutions.

Observations and Recommendations

Management of the Function

4.9 The cash management function has not been generally recognized as an important, government-wide support activity involved with administering all government payments, deposits and cash balances, billing and collection of moneys owed to the government and arrangements with the financial institutions. Good cash management can lead to major savings of public money. A visible, active and well co-ordinated cash management function is essential if such savings are to be realized.

4.10 Cash management roles and responsibilities, including co-ordination of the function, are not clearly defined and are carried out in such a fragmented way that overall authority, responsibility and accountability for cash management in the federal government is virtually non-existent. For instance, our discussions with officials of the Department of Finance, Receiver General and Office of the Comptroller General indicated a wide divergence of opinion as to which organization is ultimately responsible for cash management in the government.

4.11 Because no one organization has clearly defined responsibility for all aspects of cash management, the cash management function, with the exception of the administration of the CRF, has received relatively little attention until recently. Government-wide cash management objectives and priorities remain vague, particularly with respect to such fundamental activities as billing and collection of amounts owed to the government, processing and depositing receipts and processing and paying accounts. In departments for example, we noted relatively little concern for the cost of money although the cost of money is a major component of good cash management. The terms "cash management" and "cost of money" rarely appear in the policies, guidelines and directives issued by the central agencies. No organization had been given the responsibility of monitoring the relationship between the amount of indirect compensation given to the financial institutions and the quality, type, volume, value and level of service received. The government had not issued any directives or guidelines establishing a framework for evaluating this relationship. There is a need to clearly define the roles and responsibilities of the individual departments and agencies for cash management.

4.12 We did note that in the day-to-day operations of the CRF, the Receiver General has taken many initiatives such as the introduction of systems to accelerate the deposit of public money into interest earning accounts and the arrangements for the direct deposit in the Bank of Canada of cheques over $50,000 by all departments in the National Capital Region. Similarly the Office of the Comptroller General has recently initiated a number of studies designed to contribute to better cash management in the government such as a review of ways to eliminate payments in advance of need to Crown corporations and a study of the timeliness of payments to suppliers.

4.13 At the same time, we believe the problems and missed opportunities for savings identified in this chapter are directly related to the lack of clarity of roles, responsibilities and relationships referred to earlier.

4.14 **The government should clarify the roles, responsibilities and relationships for the cash management function to ensure that all aspects of the function are carried out with due regard for economy and efficiency. The government should also ensure that there is a process in place to co-ordinate the various responsibilities and activities of the central agencies.**

> *Department's response: First, it should be noted that there are co-ordinating arrangements between the Receiver General, Department of Finance and the Comptroller General which have been in place for many years. These include the daily exchange of information and regular meetings of officials. As well, the Interdepartmental Committee established to negotiate revised banking arrangements has, since 1981, opened a number of avenues towards overall co-ordination. However, a study to determine whether it is necessary to clarify and further co-ordinate the roles and responsibilities for cash management would appear to be in order.*

Cost of Existing Banking Arrangements

4.15 A major element of good cash management is an appropriate set of arrangements with the financial institutions for the economic purchase of banking services, such as cheque and deposit processing, and for maximizing interest earned on cash balances with the financial institutions. The current arrangements, in place for the last 25 years, provide that the financial institutions render banking services to the federal government without direct compensation. However, the interest-free use of certain government cash balances by the financial institutions represents a form of indirect compensation to these institutions for the services they render to the federal government.

4.16 At the time of their adoption in 1959, the arrangements provided for the payment of interest on government cash balances on deposit with the financial institutions at rates and on terms which, based on the limited information available, appeared to be better than those generally available to even the largest clients of the financial institutions. However, changes in banking practices have since significantly eroded the government's position. For example, the government still only earns interest on its minimum weekly cash balance while the financial institutions have been paying interest on daily cash balances for several years.

4.17 The government receives a range of banking services without direct charge, the most significant of which involve the processing of:

- government cheques and warrants;
- direct funds transfers;
- postal money orders;
- government deposits; and
- payments made at the banks by businesses and individuals.

4.18 In return, the government compensates these financial institutions for these services by allowing them interest-free use of certain cash balances such as:

- $100 million, representing the first $100 million in total of government cash balances allocated to all eligible financial institutions;
- daily government cash balances, to the extent that they are in excess of the minimum weekly government cash balance;
- government funds in transit through the banking system;

4.19 The government had not calculated the value of this indirect compensation to the financial institutions at the time of our audit. Consequently, the government did not know how much it was paying for banking services received. Because payment for services rendered is made indirectly to the financial institutions, the cost to the government of these banking arrangements is not identified or disclosed separately in the accounts of Canada. We believe this lack of knowledge and thus, of disclosure of these costs has played a significant part in the apparent lack of concern in the government for the cost of the existing banking arrangements.

4.20 As part of our review, we estimated the indirect cost of banking services in terms of lost interest for the five fiscal years from 1979-80 to 1983-84. We considered several rates of interest before selecting 90 per cent of the 91 day Treasury Bill rate. We recognize that other rates such as the Deposit Receipts rate, with or without discounts for volatile portions of the government's cash balances, or a combination of rates could have been used in these calculations. Given the number of possible variations to rates that could be used, we chose the Treasury Bill rate solely to provide an example of the magnitude of dollars involved and the volatility of costs to the government from period to period. This rate is also the reference rate used under the existing arrangements with the financial institutions. The use of other rates or rate combinations could obviously result in higher or lower cost estimates. We also recognize that this was a period of unusually high and volatile interest rates. The actual cost of banking services over this period would have depended on what prices the government could have negotiated at any particular point in time for its banking services and for the rate of return on its cash balances.

4.21 We estimated the cost of banking services over this five-year period to be approximately $348 million or an average annual cost of about $70 million with substantial variations in annual costs. We did not attempt to calculate costs prior to 1979.

4.22 As part of our review, we examined the relationship between the indirect compensation to the financial institutions and the type and volume of banking services received. The cost of these services to the federal government in the form of lost interest varies according to the size of its cash balances and with the level of prevailing interest rates rather than on a relatively stable cost-per-service-rendered basis, such as cost per item processed.

4.23 We believe the government could have saved upwards of $261 million or an average of about $52 million annually for the five-year period from 1979 to 1984. This shows a lack of due regard for economy with respect to the cost of the government's banking arrangements. If the government had monitored these costs, it would have been in a position to take action to ensure that value for money was obtained in relation to services acquired and could have modified the arrangements as appropriate.

4.24 The government should ensure that the cost of services rendered by the financial institutions is monitored at least annually, and where appropriate, that modifications are made to the agreements with the financial institutions.

Department's response: We are in full agreement with this recommendation. The costs of banking services to the government resulting from various proposals under discussion for a revised agreement with the financial institutions have been calculated and are updated as necessary. This practice will continue once a new agreement is in place. With respect to the potential cost savings as presented in the report, it should be noted that the implicit cost of the existing arrangement for banking services fluctuates considerably from year to year as a result of interest rate movements and is very sensitive to assumptions about the rate of interest that the government would receive in a new arrangement.

Renegotiation of Financial Arrangements

4.25 Negotiations for revising the government's banking arrangements with the financial institutions began in May 1982 and were continuing at the time of our audit. While we recognize that many issues need to be resolved in moving to direct compensation, any delays in negotiating and implementing the new arrangements will postpone cost savings which our calculations have shown can be quite substantial.

Billing, Collection, Deposit and Payment Practices

4.26 **Billing and collection.** Billing and collection practices directly affect how quickly the related funds are received and deposited. Although our work in this area was limited to a general review of practices in 10 departments and agencies, future comprehensive audits of the major revenue-earning departments and agencies will include a detailed examination of the adequacy of billing and collection practices. However, we believe that the government could achieve significant savings by improving these procedures. In general we found that the departments examined gave a low priority to the prompt collection of money owed to the government. For example, at 31 July, 1983, one department had accounts receivables of $3.8 million of which $2.5 million (86%) were more than 90 days old. A reduction to an acceptable average of 30 days would result in approximately $39,000 of additional interest earned annually.

4.27 **The government should review and monitor practices and procedures for billing and collection activities, and take appropriate action to remedy any problems.**

Department's response: We recognize the need to maximize and expedite the collection of receivables and the deposit of receipts. Moreover, we are aware of the potential for cash management savings brought about, in part, by recent improvements in banking technology.

This was specifically reflected in the Treasury Board recommendations that resulted in the following Bill C-96 amendments to the Financial Administration Act which facilitate: the location of debtors (s.5(7)); the recovery of accountable advances (s.31) and public money (s.89)); the setting-off of receivables against moneys owing by the Crown (s.95 and the receipt of security for debts due the Crown (s.95(1)). In addition, proposed Debt Write-off Regulations have been *drafted. These regulations are directed at ensuring that debts are not written off unless there is clear evidence that they are absolutely uncollectable or that further collection action is not economically viable.*

With respect to directives, the Office of the Comptroller General has just completed a review of the "Accounts Receivable" section of Chapter 10 of the Guide on Financial Administration in order to ensure that, in particular, there are clear directions and guidelines for rigorous collection and follow-up of all outstanding receivables.

In addition, the Office of the Comptroller General has launched a major study on the "management of receivables" which is directed at identifying any potential for improvement in this area. This study, involving the participation of departments accounting for eighty per cent of receivables, will assess collection strategies and deposit policies and systems.

4.28 **Deposit.** Another important component of good cash management is minimizing the time required to process deposits and payments within government and through the banking system. By speeding deposits into its bank account and by making payments only when they are due, the government can use its cash to maximize the interest earned on it or reduce debt. Accordingly, we examined the major deposit and payment practices of the government. This work was aimed at identifying and quantifying, where possible, opportunities for making significant savings.

4.29 To facilitate payment of income tax during the fiscal year, individuals and corporations can deposit money owed to the government direct with the financial institutions. Our examination of a sample of these deposit transactions indicates that the financial institutions take an average of 2.3 calendar days to deliver these deposits to the Bank of Canada. However, the banks state that they can give same day service. To quote from a publication by one of the leading banks, "Canadian banks can give same day value for deposits from coast to coast, regardless of account location". We question why the government has not taken advantage of this same-day service offered to other financial institution customers. The failure to receive same day service costs the government about $18 million in lost interest each year.

4.30 **In its negotiations with the financial institutions, the government should ensure that it gets same-day service from the financial institutions, or some equivalent benefit from the institutions in lieu of receiving such service.**

Department's response: We agree with this recommendation. The Receiver General will continue to seek to obtain the fastest possible service and has, in fact, reduced the average time steadily over the past ten years. The current negotiations are explicitly taking into account the cost of any delays in the transfer of money.

4.31 Money received by departments and agencies is deposited with the financial institutions. These deposits are not, however, credited to the government until after the departments and agencies have provided the Bank of Canada with a receipted copy of the Bank Settlement Voucher (deposit slip). Although deposit performance is generally good and is regularly monitored by the Receiver General, we did note that some departments and agencies did not always deliver the Bank Settlement Voucher to the Bank of Canada on the day it was received. These delays cost the government about $1 million annually in lost interest.

4.32 The Receiver General should determine whether there are alternatives to the use of the Bank Settlement Voucher that would accelerate the deposit of public money.

> *Department's response: The Receiver General has already studied possible alternatives to Bank Settlement Vouchers and identified certain alternatives for further examination. The Receiver General expects to take action to implement this recommendation once the revised banking arrangements are in place.*

4.33 The Bank of Canada accepts departmental and agency deposits of individual amounts over $50,000. All other cheques must be deposited with other financial institutions. While this service avoids delays in crediting these large deposits to the CRF, the Bank offers it only to departments and agencies located in the National Capital Region. Outside the National Capital Region, cheques over $50,000 are deposited with the financial institutions. This process adds an average of one-half day delay in completing the transaction. For example, extension of the Bank of Canada deposit or similar facility to National Revenue - Taxation data centres located outside the National Capital area, which had deposits of $13.6 billion for individual receipts over $50,000 in 1983-84, would result in additional interest income to the government of about $2.0 million a year.

4.34 The government should assess the feasibility of extending the use of the Bank of Canada deposit facility or some similar one such as the Receiver General's District Services Offices, to government departments and agencies outside the National Capital Region.

> *Department's response: Such a feasibility study was carried out several years ago. It was conducted by the Receiver General and National Revenue-Taxation. The study showed that the cost of extending these facilities exceeded the additional interest which could be earned. However, the Receiver General will update this study and will continue to search for possible means of extending deposit facilities.*

4.35 Before deposits can be made, incoming cheques must be processed in the receiving department. Because the major cash-receiving departments do not maintain the necessary supporting data, they were unable to measure the time they took to process the incoming cheques in the department. We did, however, note several opportunities for improved performance. For instance, the bulk of incoming cheques at National Revenue -

Taxation data centres take one or more days to process and deposit. A reduction of one day in the processing at National Revenue - Taxation would save about $7 million annually in lost interest.

4.36 Government departments and agencies should ensure that they deposit receipts as quickly as possible.

> Department's response: *Please see the response to the recommendation at paragraph 4.27.*

4.37 **Payment.** In April 1983, the government introduced a standard payment period of 30 days for payments to suppliers of goods and services. Based on general industry standards of 30 days, we consider this practice to be reasonable. According to studies conducted by the Office of the Comptroller General with the assistance of the Receiver General, the introduction of this practice has resulted in 80 percent of suppliers invoices being paid within 30 days. This speeding up of payments has also accelerated payments which were already being paid on time. As a result, up to $2.2 billion (36 per cent) of suppliers' payments are being made at least 20 days earlier than the standard industry payment period of 30 days. Based on this study, the cost to the government of these early payments is between $18 and $22 million in lost interest for the 1983-84 fiscal year depending on the number of days allowed for mailing.

4.38 The government should ensure that, to the extent possible, payments to suppliers are made when due, that is, neither early nor late.

> Department's response: *As evidenced by your staff, the analysis done by the Office of the Comptroller General as the basis for the 30-day payment policy also included a determination of the cost of paying early. In light of the recommendation, appropriate action will be recommended.*

4.39 Although our review did not include an examination of cash management within Crown corporations and agencies, we did examine payments made by departments to Crown corporations and agencies to meet operating expenditures, cover deficits and to assist with capital investment programs. As reported in previous years, departments are remitting funds to Crown corporations and agencies before the money is actually required. We were unable to quantify the net cost to the government of making these advance payments because we did not have access to Crown corporation cash flow forecasts and other supporting information. Eliminating this practice could result in substantial interest savings to the government.

4.40 We are pleased to note that the Office of the Comptroller General, with the cooperation of the Receiver General, is developing a proposal that should eliminate most (if not all) of these advance payments. The system is already being used by Canada Post Corporation, and we encourage its consideration with respect to other Crown corporations and agencies.

4.41 In summary, we estimate that the current deposit and payment practices are costing the government at least $43 million annually in lost interest, as shown below:

Lost Interest Revenue	$ Millions
Delays in the financial institutions in clearing payments made directly by businesses and individuals	$ 18
Delays by departments and agencies in delivering receipted copies of their deposits (Bank Settlement Vouchers) to the Bank of Canada	1
Delays in clearing large deposits of departments and agencies outside the National Capital Region	2
Early payments to suppliers	22
	$ 43

INTERNAL AUDIT

INTERNAL AUDIT

Table of Contents

	Paragraph	Page
Evolution of Internal Auditing	5.1	5–1
Audit Purpose and Scope	5.7	5–4
Objectives and Effects of Internal Auditing	5.13	5–5
Observations and Recommendations		
Follow-up of 1978 Auditor General Study	5.20	5–7
Audit Planning	5.22	5–7
Long-range and Annual Planning	5.24	5–7
Assignment Planning	5.27	5–9
Audit Coverage	5.33	5–10
Audit Reports	5.39	5–11
Annual Reports	5.43	5–12
Follow-up and Implementation	5.49	5–13
Self-evaluation	5.55	5–14
Audit Committees	5.58	5–15
Other Concerns	5.63	5–16
Central Direction	5.65	5–16
Reliance	5.68	5–17
The Government's Response		5–20
Exhibits		
5.1 Chronology of Key Events in the Evolution of Internal Auditing in the Government of Canada		5–2
5.2 Comparison of the Number of Internal Audit Groups Meeting Criteria or Standards in 1978 and 1984		5–8
5.3 Summary of Standards for Internal Audit Office of the Comptroller General		5–18

5

INTERNAL AUDIT

Evolution of Internal Auditing in the Government of Canada

5.1 The importance of internal audit has been recognized in the Government of Canada for over two decades. The Office of the Comptroller General of Canada (OCG) defines internal audit as an independent function that carries out a systematic review and appraisal of all departmental operations for purposes of advising management on the efficiency, economy and effectiveness of internal management policies, practices and controls.

5.2 Since the 1962 Report of the Royal Commission on Government Organization (Glassco), the government has taken several important initiatives to spur the development of the internal audit function. Exhibit 5.1 lists the key events in this development.

5.3 In 1978, the Office of the Comptroller General initiated a major effort to improve the quality of internal auditing throughout the government. First, in 1978, it developed and issued Standards for Internal Financial Audit in the Government of Canada.

5.4 Second, in 1980, the OCG began an effort to establish broad scope internal audit throughout the government and to address specific audit issues resulting from the IMPAC surveys of departments. It established an Internal Audit and Special Studies Division which took a variety of steps to assist and guide departments in establishing internal audit units capable of examining and reporting on all functions and operations within departments. The Division provided departments with assistance and advice in preparing policies and plans, staffing senior positions, developing audit methodologies, and designing and delivering training. As well, the Division has conducted regular formal reviews of internal audit units and has made recommendations for improvements.

5.5 Third, in 1981, Treasury Board, through the Office of the Comptroller General, circulated draft Standards for Internal Audit to deputy ministers. These standards, which were approved by Treasury Board in 1982, required a major shift in internal audit activities from financial auditing to the examination of all functions and operations of departments. The revised standards resulted in a significant and fundamental shift in the nature, scope, purpose and importance of internal auditing in departments and agencies.

5.6 Internal audit functions of departments and agencies were given more resources and increased visibility through higher reporting levels. In pursuing the implementation of effective internal audit, the Office of the Comptroller General established three priorities, all of which were to be addressed concurrently, but with changes in emphasis over time, as follows:

CHRONOLOGY OF KEY EVENTS IN THE EVOLUTION OF INTERNAL AUDITING IN THE GOVERNMENT OF CANADA

• 1962	- The Royal Commission on Government Organization (Glassco Commission) recognized the importance of internal auditing and stated that "internal audit groups are an invaluable aid to departmental management".
• 1966	- Cabinet approved the Glassco recommendation to implement internal audit. - The Treasury Board Financial Management Guide encouraged deputy heads to establish operational audit functions to review and appraise all accounting, financial and operational controls.
• 1973	- The Treasury Board Guide on Financial Administration made it mandatory for all departments and agencies to have their financial management systems audited.
• 1975-76	- The Auditor General's 1975 and 1976 Reports included "The Financial Management and Control Study (FMCS)", which dealt in part with internal audit, and said that the scope and quality of internal audits could be substantially improved.
• 1976	- Treasury Board approved the creation of a Financial Administration Branch. One of its expanded responsibilities was the establishment of a program to improve the effectiveness of financial auditing.
• 1978	- The Auditor General conducted a more in depth review of internal audit in departments and agencies than was done in the FMCS. - The Office of the Comptroller General issued Standards for Internal Financial Audit and included internal audit in its IMPAC review of departments.

Exhibit 5.1

- 1979 - The Royal Commission on Financial Management and Accountability (Lambert Commission) recommended a comprehensive approach for internal audit which encompassed financial, operational and management audits, including audits of compliance with centrally prescribed policies and procedures. It also recommended that audit committees be created.

- 1980 - The Office of the Comptroller General established the Internal Audit and Special Studies Division in order to provide central direction and leadership to the internal audit community and to monitor performance of internal audit groups.

  - The Office of the Comptroller General issued a Policy Circular on Co-ordination of Audit Activities (1980-3), describing criteria for Treasury Board reliance on internal audit for assessing compliance with T.B. policies.

- 1982 - The Office of the Comptroller General issued Standards for Internal Audit to include a review of the internal management policies, practices and controls for all operations. The scope of internal audit was formally expanded to include all functions and operations of departments.

- initially, to assist departments in establishing an appropriate audit structure, including departmental policies, organization, reporting relationships, audit committees, long-term and annual plans, and annual reports to deputy heads;
- next, to see to the development of appropriate audit methodology for conducting non-financial audits, and to ensure appropriate training for audit staffs, with emphasis on the conduct and reporting of individual audits; and
- finally, to foster improvements in the quality of the audits and audit reports in all departments and agencies, and to increase and formalize the reliance by central agencies on internal audit.

Audit Purpose and Scope

5.7 One of the purposes of this review was to update our 1978 study and to report the extent to which departmental internal audit groups are conforming to the OCG standards document (set out in Exhibit 5.3 at the end of this chapter) and the extent to which our Office can rely on the work of internal audit. We also attempted to determine the contribution internal audit is making, at this stage of its evolution, to improving departmental operations. As a result, we concentrated more on the outputs of internal audit than on the adequacy of the organizational structure and management process, as was the case in 1978.

5.8 In our 1978 government-wide study of internal audit, there were significant deficiencies in most of the 35 departments and agencies reviewed. At that time, problems were noted in the scope, planning, conduct and reporting of audits; in audit policy; in the organization, staffing and reporting levels of audit groups; in management support for audit; and in follow-up of audit findings.

5.9 In this study we reviewed and updated our knowledge of the internal audit functions in 31 of the 35 departments and agencies covered in the 1978 study. Government reorganization is responsible for the different number of departments in the two studies.

5.10 We examined activities carried out by the Office of the Comptroller General in providing guidance to the internal audit function throughout the federal government. In this connection, we examined relevant information maintained by the Office of the Comptroller General on the level of internal audit activity across 49 departments and agencies. After testing the data base, we concluded that we could place reliance on the information provided to us by the Comptroller General's Office, thereby avoiding duplication of effort.

5.11 For this study, we chose the following 14 departments for an examination of internal audit activities. The 1983-84 resources allocated by these departments to internal audit activities were 336 authorized person-years and $20 million. These departments accounted for approximately 50 per cent of the total person-year and dollar expenditures on internal audit in departments and agencies.

- Consumer and Corporate Affairs
- Communications
- Employment and Immigration
- Fisheries and Oceans
- National Health and Welfare
- Indian Affairs and Northern Development
- Labour
- National Library and Public Archives
- National Revenue - Customs and Excise
- Public Works
- Solicitor General
- Statistics Canada
- Transport
- Veterans' Affairs

5.12 Comments on the internal audit groups of the Canadian International Development Agency and the Department of National Defence are set out in the respective comprehensive audit chapters. The findings are generally consistent with the results of this study. They are not included in this report because of differences in timing of the audit work.

Objectives and Effects of Internal Auditing

5.13 The purpose of internal audit is to independently review and assess management controls in major financial, administrative and operating areas and make recommendations for improvements wherever beneficial. Such reviews are designed to assist managers by identifying weaknesses or opportunities to improve the overall economy, efficiency and effectiveness of their internal management policies, practices and controls. Specifically, internal audits should determine that controls are in place to ensure that the information used for management and accountability purposes is reliable and accurate; legislative, central agency and departmental directives are complied with; and appropriate safeguards exist to ensure the economical and efficient use of resources and protection of public assets from losses of all kinds.

5.14 The auditor must be careful to avoid recommending changes in systems, procedures and controls that will result in only marginal improvements. This normally produces additional costs and, on the part of managers, frustration about the additional constraints and controls and a negative reaction to the auditor as being impractical and counter-productive. Therefore it is important that auditors, in planning and carrying out the audit and in making observations and recommendations, be concerned with the impact and the effects of their work. They should be reasonably satisfied that the benefits of adopting their recommendations will outweigh the cost of implementing them.

5.15 Impacts and effects which are desirable in a government organization include:

- improved services to the public;
- cost savings and higher revenues;
- better use and conservation of resources;
- enhanced compliance with legislation, policies and directives; and
- deterrence of potential abuse and fraud.

5.16 We reviewed hundreds of internal audit findings during this audit. Not surprisingly, most dealt with implementation of one or more aspects of internal control. For most of these, it was difficult to measure the extent of their impact on departmental operations because they dealt with enhanced compliance and deterrence. A few, however, have had a significant demonstrable effect on departmental operations, as the following examples illustrate.

5.17 **Case 1.** One department was making radical changes to all its major systems. Millions of dollars were being spent on this development. In compliance with the Office of the Comptroller General's standards, the internal audit group conducted the pre-implementation work on these major system changes. The group's review and subsequent report indicated that both the time required for completion and the resource requirements had been greatly underestimated. It also determined that progress was not as advanced as was being reported. The internal audit findings were a contributing factor in senior management's decision to re-evaluate the situation, substantially extend the implementation timeframes and develop an incremental plan. The assessment and report by internal audit thus reduced the likelihood of inappropriate development work as well as of costly changes after implementation.

5.18 **Case 2.** A department initiated a contribution program which required inspection to ensure that the work for which the contribution was being paid had been properly carried out. When the program's development was complete the internal audit group conducted a pre-implementation audit. The group recommended reducing the number of inspections to be made under the program, pointing out that the reduced number of inspections would still make it possible to arrive at a statistically significant conclusion on the operation of the program. The estimated potential saving was approximately $600,000.

5.19 **Case 3.** A department undertook an audit of materiel and property management. The audit revealed that the department was occupying space in excess of Treasury Board guidelines. As a result of the audit recommendations there was a consolidation, and 4,200 square metres of space were returned to the Department of Public Works. This will result in annual savings of approximately $650,000. An additional benefit was that program managers became more aware of the costs of excess space.

Observations and Recommendations

Follow-up of 1978 Auditor General Study

5.20 We observed that, in the years since our 1978 study, the government has made significant progress in establishing the infrastructure for broad scope internal audit in departments and agencies. These improvements overcome most of the deficiencies noted in the 1978 Report.

5.21 Exhibit 5.2 illustrates the substantial improvement achieved by internal audit groups in meeting certain key standards or criteria since the 1978 audit. We examined 35 departments and agencies in our 1978 study and 31 in this study. Our findings are consistent with the progress reported in the IMPAC follow-up included in Chapter 17 of our 1983 Report. Establishing a proper infrastructure does not guarantee that the internal audit function will be effective; however, it is a prerequisite for effectiveness.

Audit Planning

5.22 The typical government department is a complex conglomeration, sometimes spending billions of dollars and employing thousands of people. In many instances, departments are responsible for a wide range of activities requiring diverse methods of program administration and funding. The administrative structure may be widely dispersed across the country, with significant decentralization from senior administrative control in Ottawa. The varied scope, size and complexity of operations and the limited resources devoted to audit make it impractical for internal auditors to cover all aspects of departmental operations in depth. Primary emphasis must be given to matters of significance. This is recognized in the Standards for Internal Auditing in the Government of Canada which state that "planning gives the head of internal audit a means of ensuring that every component of the audit group's responsibility is considered, and of organizing the work in a manner that will gain the greatest benefits for the department from the (audit) resources utilized."

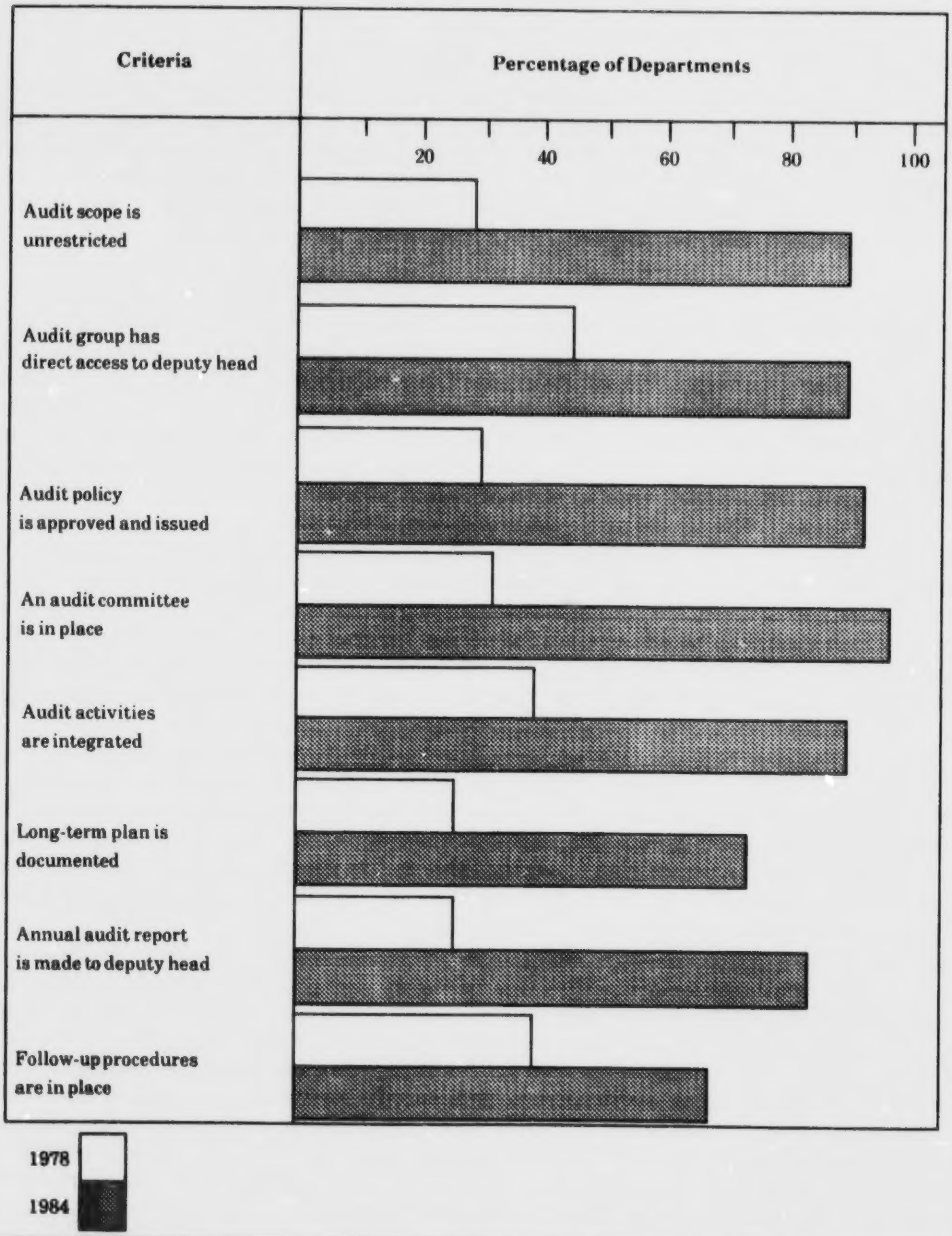
5.23 Planning is also required for managing audit activities and evaluating the performance of the audit group. The 1982 Standards for Internal Audit require that departments have a long-term plan (covering three to five years), an annual plan approved by the deputy head, and proper assignment plans. In this study we examined how departments carried out the processes of planning.

Long-range and Annual Planning

5.24 The OCG Standards for Internal Audit require audit groups to sub-divide their total audit responsibility or audit universe into specific auditable units and to assess the importance of these units in terms of such factors as materiality, risk of loss, importance to management and previous audit coverage. It points out that this is a particularly important step, as it forces audit managers to focus their attention on areas where use of available resources would best achieve the departmental audit objectives.

Exhibit 5.2

COMPARISON OF THE NUMBER OF INTERNAL AUDIT GROUPS MEETING CRITERIA OR STANDARDS IN 1978 AND 1984



5.25 For all audit groups included in our review, a long-range plan had been developed and approved by the deputy head. We noted that audit groups had sub-divided their total audit universe into audit units and had generally identified factors for establishing priorities. However, there was little documentation to indicate that the factors were used to establish the importance of an area for audit. In practice, we found that some groups audited all areas identified without apparent concern for their relative importance. Annual audit schedules also did not indicate that departments had given sufficient consideration to using audit resources where they would produce the most benefit. This increases the likelihood that audit resources will be used in areas of limited importance relative to other areas of the department.

5.26 Departments have made progress in reflecting the expanded scope of audit in their plans and attempting to develop priorities for audits. There is a need to consider the relative importance of the areas to be audited, to ensure that audit resources are applied most effectively. We believe that, with the experience gained from the first cycle of audits under the standards, departments should refine their long term and annual planning activities to ensure that audit resources are applied to the areas of highest priority with the greatest potential payback for the department.

Assignment Planning

5.27 After selecting an area for audit, and before beginning the audit, internal audit groups prepare specific audit assignment plans. The assignment plan is intended to identify the issues to be emphasized, the audit techniques to be used, and details of the time and costs of the project. During the course of the audit, adjustments are made as additional information is obtained.

5.28 While audit groups do develop assignment plans, we believe they should generally have more interaction with senior management and carry out more rigorous and systematic analysis of potential audit areas to identify the major issues, weaknesses in controls, or opportunities for improvement. This is normally done in a preliminary survey phase prior to committing audit resources for the entire audit. The result of not conducting such in-depth analysis is that minor areas may be over-audited while key areas are under-audited, reducing the overall effectiveness of the audit.

5.29 Allocation of resources to the audit should not be finalized until there has been this kind of preliminary analysis. Only then can the audit group be confident that its limited audit resources are being applied in the most productive and effective manner. It was apparent from our review of audit files and reports in many departments that considerable audit resources had been expended without adequate risk analysis. This can lead to auditing relatively low priority items, resulting in findings that are not significant.

5.30 The Office of the Comptroller General has now issued draft guidelines for the development of audit plans as part of its handbook for departmental audit managers. These guidelines provide further interpretation of the standard relating to frequency of audit, addressing such issues as the choice of appropriate audit selection criteria and the methods of applying them to departmental organizations and systems.

5.31 Internal audit groups should improve their planning process by ensuring that audit plans submitted to the audit committees identify and schedule the audit assignments according to priorities, determined on the basis of management concerns, materiality, and potential risks and benefits to the department. These should be documented in audit plans.

5.32 Internal audit groups should conduct preliminary analyses of potential audit areas to determine what major issues, weaknesses or opportunities could be expected to emerge as a result of an in-depth audit. This would help to ensure that scarce audit resources are applied as productively and effectively as possible.

Audit Coverage

5.33 In recognition of the need to strengthen the accountability process, the new Standards for Internal Audit in the Government of Canada were issued by the Treasury Board in May 1982. These standards called for an expanded scope of internal audit coverage which would enable internal auditors to provide an independent assessment of the economy, efficiency and effectiveness of internal management policies, practices and controls. They were designed to improve the quality of internal auditing and make it a more effective management tool, which would contribute to improving departmental management practices.

5.34 We found that the depth of audit coverage varied considerably among departments. Although audit groups generally planned to audit program and operational areas of the department, there was a tendency to concentrate their actual coverage on the financial and administrative aspects. Internal audit groups in many departments did not examine the operational effectiveness of internal management policies, practices and controls or adequately review significant value-for-money aspects of operational systems. For example, most audit groups examining departmental operations or programs have not yet focused adequately on management's concern for productivity and efficiency. While there has been a substantial expansion of previous coverage, we found that, in 10 of the 14 audit groups, there was a need to improve coverage of these aspects.

5.35 We also noted that:

- In 8 of the 14 departments and agencies, major EDP components of systems had not yet been audited.

- Two groups only audited regions when carrying out department-wide audits of functional areas, leaving the possibility of significant gaps in audit coverage of regional operations. Functional and organizational audits should both be considered in planning audit coverage.

- Although Treasury Board policy states that internal auditors should become involved early in the systems development process, to ensure that necessary audit and control features are built into new systems, most internal audit groups were not adhering to this requirement. The cost of incorporating these features after major systems have been implemented can be prohibitive. We believe it is important for auditors to become involved at the early stages of development.

- In one department where there had been significant activity in developing EDP systems, internal audit had performed only limited reviews before implementation. Senior management expressed the concern that considerable risk existed that systems problems or deficient controls might not be identified until after implementation. It was management's view that it would require considerably more effort and cost to modify or correct the system at that stage than it would have prior to implementation. This is the type of concern that senior managers should raise in meetings of the audit committee.

- This view was borne out by the experience of another department, where an internal audit examination and assessment of a major system prior to implementation identified major weaknesses in the system and in the plan for implementation. Consequently, the system underwent further development, which may well have prevented a major disruption of services.

5.36 The adequacy of audit coverage depended on various factors, including availability of staff with the skills and knowledge necessary to conduct audits in operational areas, quality of audit planning, management support, and the methodology available for auditing in non-financial areas.

5.37 We note that the Office of the Comptroller General, in co-operation with central agencies, audit groups and subject-matter experts in departments, is in the process of developing audit methodology for a large number of non-financial areas.

5.38 **Internal audit should continue to expand its audit coverage to include assessment of the most significant aspects of departmental operations, such as computer-based systems, and of the cost-effectiveness of internal management practices and controls.**

Audit Reports

5.39 The primary product of the internal audit process is a report addressed to departmental management. One of its purposes is to provide assurance to senior management on such subjects as the effectiveness of major operating systems and controls of the department; whether adequate and reliable information is available and is used in decision making; whether resources are being acquired and used with due regard for economy and efficiency; and the extent of compliance with laws, policies and procedures. The other main purpose is to make recommendations for improvement. To achieve these

objectives, reports should be presented promptly after the audit, and reports to senior management should include detailed comments on only the important issues, with a notation that issues of lesser importance have been reported to the appropriate level of management.

5.40 **The Standards for Internal Audit require that the written report be concise, timely, complete, include only significant findings and make recommendations where appropriate.** The results internal audit achieves depend to a large extent on how well these criteria are satisfied. Progress has been made in improving the reporting process, but, not unexpectedly, there was a wide range in the adequacy and significance of audit reports in the various departments included in our study. In reviewing reports, we found that, with some notable exceptions, reporting of audits generally needs improvement. There is ample evidence to indicate that the full potential benefits of audits are not being attained.

5.41 We noted the following problems:

- Reports contained numerous observations of little significance to senior management. This problem was typical for most departments. In many of the departments, minor items were found throughout the report which tended to distract management attention from significant matters. Where more significant observations were summarized, they were stated in such general terms as "financial controls over...require strengthening" or "operational procedures ... require improvement". The summaries themselves were long.
- Reports were frequently not finished and issued on a timely basis. While draft reports were given to the auditee, final reports to the audit committee were often issued four to six months after completion of audit work. We found instances of delays of up to two years. The total reporting process involves drafting the report, clearance of findings with management, supervisory review of the report and translation.
- Frequently reports did not provide sufficient information on causes of problems or on what had gone wrong or could go wrong if the situation remained unchanged. In general, the reports did not contain the type of information necessary to convince readers that the problem warranted attention. We found that many of the audit groups did not adequately weigh the benefits to be gained from their recommendations against the cost of implementing them and the possible disadvantages of added controls.

5.42 Internal audit report users interviewed during our review frequently expressed similar concerns about audit reports.

Annual Reports

5.43 **The Standards for Internal Audit require that internal audit units submit at least annually a report to the deputy head, describing the unit's activities and results during the previous year.**

5.44 Most departments we reviewed included in their annual internal audit reports to deputy heads an accounting of their activities and results. The annual reports provided:

- information on audits actually conducted compared to approved plans, with explanation of variances;
- highlights of the more significant issues reported by internal audit during the previous year; and
- information on corrective action taken in response to recommendations.

5.45 We found that there were cases where it appeared that little effort had been made to link findings from different audits to determine whether the matter had a general or cumulative significance. In one situation of this sort, a deputy head was not made aware of major problems because the significance of the issue was not apparent from the detailed observations contained in a number of separate reports on field operations.

5.46 Problems we found with audit reports could be traced to all phases of the audit process, from initial planning to the actual writing of the report. In general, it appeared that the most frequent problems were related to the limited experience of some auditors in examining and analysing non-financial areas, the failure to identify causes and effects of problems and the practice of including in the report to senior management all findings, both minor and significant. A contributing factor may be management's acceptance of findings and recommendations, whether or not they believe they are consequential, and making no commitment to take corrective action.

5.47 **Recommendations made in individual reports should be reviewed and integrated, if appropriate, to ensure that the full extent of similar or related findings is revealed, thereby facilitating an understanding of the overall significance of the deficiencies observed.**

5.48 **Audit reports should be concise, should be issued promptly, and should describe problems in clear terms that include causes as well as actual or potential consequences, particularly where this is necessary to convince managers that the problems need attention.**

Follow-up and Implementation

5.49 The quality of an audit recommendation has a significant bearing on the degree of acceptance with which it will be received and its likelihood of producing constructive change. In addition, an appropriate follow-up system is necessary to ensure that valid recommendations are implemented and that this is done in a way that addresses the deficiencies they were intended to correct. The audit standard on follow-up states that the internal audit group should assess whether appropriate action has been taken to implement audit recommendations and should report inadequate action.

5.50 We found that a number of long outstanding recommendations had not yet been implemented. This may indicate that the benefit from implementing the recommendation is not clear, the matter is not of significance in relation to cost of implementation, or that there is a lack of management commitment. Most of the internal audit groups we examined had an audit follow-up process, either as a separate activity or on a next-cycle basis. While judgement is required as to how audit resources should be allocated between follow-up and audit activities, it is essential to track corrective action on major recommendations and to ensure that such recommendations achieve the desired results.

5.51 This kind of monitoring could also be a way of periodically assessing the performance of internal audit. It would supply information to the audit group on the extent to which it was providing useful service and contributing to the accomplishment of departmental objectives. If monitoring revealed that a recommendation did not achieve the desired result, the information gained in the monitoring process could be used in reassessing the audit approach.

5.52 In our opinion, there is a need for departments to improve their procedures for examining the action taken on audit recommendations and the extent to which they achieved the desired result. The Office of the Comptroller General has issued a Policy Interpretation Notice which amplifies the standard on follow-up and addresses this issue.

5.53 **Internal audit should improve follow-up procedures to include reporting on the effectiveness of corrective action taken to remedy deficiencies observed and reported in preceding audit reports.**

5.54 **Internal audit should use information obtained from follow-up reports to improve its audit approach.**

Self-evaluation

5.55 Internal audit is a function that supports departmental management and operations. As with all such functions, it is important that internal audit assess the contribution it is making to the department or agency. Such self-assessments can be of use to deputy heads and the internal audit groups in developing plans, selecting areas for audit emphasis and accounting for results.

5.56 Measuring the results of internal audit is not straightforward; however, in our view, internal audit should periodically review its accomplishments in terms of its contribution to the organization. It should demonstrate within reason that its services to senior management have resulted in more efficient and effective management policies, practices and controls for the department.

5.57 In the private sector, where corporate success can be defined in terms of profit, market share and return on equity, the internal audit functions of some well managed corporations define their accomplishments at least partially in monetary terms, such as reduction in costs or return on each audit dollar spent. We recognize that internal audit results are often not amenable to quantification; for example, the benefits of better compliance with the government's Official Languages policy may be apparent, but they are virtually impossible to quantify. However, internal audit units should, where feasible, document the effect of their activities on departmental operations. We believe such assessments would be of benefit to internal audit units and to deputy heads by providing a practical demonstration of the contribution of internal audit to improved departmental operations.

Audit Committees

5.58 Audit committees can supply important support to internal audit groups by:

- providing advice and direction on significant areas for audit;
- monitoring corrective action on major audit recommendations;
- ensuring that adequate resources are provided to the internal audit group; and
- safeguarding the group's independence.

5.59 The Standards for Internal Audit acknowledge these functions and provide good guidelines for an effective committee.

5.60 All the departments we examined in our study had established an audit committee. In spite of this positive observation, in some departments we examined, we found the following:

- Some committee meetings were little more than a formality. Committees often met for a short period immediately preceding a regular meeting of the management committee, which had identical membership. In most departments, audit committees consisted of the entire senior management group.
- Certain members of audit committees did not appear to clearly understand their roles and responsibilities, or what was expected of them. Effective functioning of members would be enhanced if there were a formal appointment letter stating these clearly.
- The size of audit committees can prevent them from operating effectively. Many departments have the full complement of senior management as members. It is difficult to determine the optimum size of an audit committee; this question needs review. However, a number of committees appear to be too large to be really effective.

5.61 If an audit committee has the appropriate membership, meeting and reporting arrangements, and its members are given appropriate responsibility, it can provide a useful means of improving the methods by which departmental goals are achieved. An audit committee can make a significant contribution to departmental performance by improving the status and effectiveness of the internal audit function. We note that the Office of the Comptroller General has issued further guidance on the composition and functioning of audit committees, as part of its handbook for departmental audit managers.

5.62 **A department or agency should provide a formal appointment letter to members of its audit committee, explaining their responsibilities.**

Other Concerns

5.63 **Electronic data processing (EDP).** The federal government spent about $610 million and employed about 10,000 person-years in EDP activities in 1982-83. Electronic data processing has become a key feature of the government's operations. The scale and pervasiveness of computing activities in departments make it vital that they be examined by internal auditors. The OCG provides guidance on auditing computer-based systems; however, many departments we examined did not have a sufficient number of EDP audit specialists who could audit EDP systems, review controls in computer systems, either existing or under development, or make use of the computer to assist them in carrying out their audits.

5.64 **Head of internal audit.** The internal audit group has significant responsibility for assessing the management process, and senior management should be able to place a high degree of reliance on its appraisal of departmental operations. How well the group functions depends to a large extent on the capability of the head of internal audit. We noted that a number of people appointed recently to this critical position had not had any prior audit experience. While experience as a line manager can be of great value in the position, experience in conducting and leading audits should be equally, if not more, important. The appointments referred to above took place at the end of our field work; we were therefore unable to determine their effect.

Central Direction

5.65 In the first stage of carrying out its responsibility for the development of internal audit across government, the Office of the Comptroller General conducted the following activities:

- developed and issued the Standards on Internal Audit and recommended them to the Treasury Board.
- conducted in-depth reviews of internal audit groups in departments, then issued reports to deputy heads on their audit group's performance against the standards, along with advice on how to improve performance (at December

1983, 19 reports had been finalized and issued; another 5 reports were in draft form); and

- established liaison between central agency policy monitoring groups and internal audit groups.

5.66 The Office of the Comptroller General is now emphasizing the second step in the process – the development of appropriate methodology and appropriate training for audit managers and staff. This activity has included the following:

- development of audit guides in co-operation with departmental groups to address a wide variety of non-financial areas;

- introduction of Policy Interpretation Notices to provide detailed guidance on specific aspects of internal audit work, for example on audit follow-up and working papers; and

- an assessment of training requirements for government internal auditors, in co-operation with the Public Service Commission.

5.67 The Office of the Comptroller General has indicated that, in 1984, it plans to emphasize development of quality control and effectiveness monitoring of internal audits and reports within departments. We believe this will be important to departments in realizing the full benefits of the internal audit functions now in place. It is our opinion that strong central leadership for the function should continue and that increased emphasis should be placed on assessing the impacts and effects of the function on departmental operations.

Reliance

5.68 One of our purposes in this study was to assess the extent to which this Office could rely on the work performed by internal audit groups within departments and agencies. To ensure that our audit work is carried out economically and to minimize duplication, we rely whenever possible on the work of a department's internal audit group. Although the audit mandate and emphasis of our Office differ from those of the internal audit groups, in recent years we have increasingly placed reliance on the audits of specific functions and procedures in some departments.

SUMMARY OF STANDARDS FOR INTERNAL AUDIT
OFFICE OF THE COMPTROLLER GENERAL

1. Departments shall have an independent internal audit function that carries out a systematic review and appraisal of all departmental operations for purposes of advising management as to the efficiency, economy and effectiveness of internal management policies, practices and controls.

2. The scope of internal audit shall encompass all aspects of a department's operations. The internal auditor assesses and expresses an opinion upon:

   (a) the design, development, implementation, and operation of all systems, procedures, processes and controls, including computer-based systems;

   (b) the reliability and adequacy of information available for decision-making and for accountability purposes;

   (c) the extent to which available information is utilized in the decision-making process;

   (d) the adequacy of protection afforded public funds and assets; and

   (e) the extent of compliance with legislative, central agency and departmental directions.

3. All major systems, functions and organizational units performing significant responsibilities should be examined within a period not exceeding three to five years.

4. The head of the internal audit group should report to the deputy head.

5. There should be an audit committee chaired by the deputy head, composed of executives whose attributes assure the provision of sound and objective counsel to the deputy head.

6. All internal audit activities shall be integrated to eliminate overlapping and duplication of work, and to contribute to the efficiency of internal auditing within the department.

7. Where audit agents are used, there should be a written agreement with each agent that specifies audit objectives, audit scope, reporting relationships, the authority of the auditors, and the rights of the department to examine audit documentation.

8. The deputy head shall approve and promulgate an audit policy which specifies the responsibility and authority of the audit group, outlines the scope and frequency of audit, and authorizes access to all departmental information necessary for the fulfilment of its mandate. The policy should specify the responsibilities of the auditees and the internal audit committee vis-à-vis the audit process.

9. Members of the internal audit group should execute each aspect of assigned audit work in a manner which is, and is perceived to be, objective.

Exhibit 5.3

10. The internal audit group should be of sufficient size and possess the skills necessary to carry out its mandate.

11. The internal audit group and the individual auditor should have a common obligation to develop and maintain professional skills through training courses, on the job training, personal self-improvement, and a formal program of annual appraisals.

12. A long-term plan of the activities of the audit group shall be prepared and documented to ensure that the organization's audit policy is met efficiently and effectively.

13. An annual schedule of planned audit assignments shall be prepared and submitted to the deputy head for approval.

14. Every audit assignment should be properly planned.

15. There should be a sufficient study and evaluation of the operational and management systems, procedures, processes and controls as a basis for conducting the detailed review and tests required to identify and disclose weaknesses and inefficiencies.

16. Each auditor should exercise due care in the performance of the audit.

17. Sufficient valid and relevant evidence should be obtained and documented to support the content of audit reports.

18. Staff engaged in all phases of an audit assignment should be subject to adequate supervision.

19. All Audit work should be subject to a properly planned and documented review process conducted by the appropriate level of qualified supervisory staff.

20. A written report shall be issued to appropriate officials of the department or agency at the conclusion of every audit assignment. The report must be timely, accurate, clearly stated, complete yet concise, and recommend corrective action when appropriate.

21. A report shall be submitted to the deputy head at least annually on audit coverage, major findings, significant unresolved recommendations and any other matters requiring the deputy head's attention.

22. Audit findings and recommendations should be discussed with relevant officials prior to issuing the report and their comments included in the report, as appropriate.

23. The internal audit group should assess whether appropriate follow-up action has been taken on the implementation of audit recommendations and it should report inadequate action.

GOVERNMENT RESPONSE

The results of this audit of internal audit activities by the Auditor General, one year after the introduction of The Standards for Internal Audit in The Government of Canada, is a useful indication of the progress made, and the directions of future work.

This report is generally consistent with the government's assessment of internal audit; with few exceptions, government departments now have appropriate internal audit organizations, policies, and processes in place; and useful audit findings concerning all functions and operations are now available to senior managers.

Implementing an internal audit program across government, that reviews and evaluates all departmental operations, is comparable to the Auditor General's conversion to comprehensive audit. The most difficult aspect of implementing this program has been attracting and retaining sufficient people with the range of skills and experience needed to evaluate the diverse operations found in a department or agency, and the ability to work effectively within the constraints of a governmental environment. It has been necessary to attract the best available people, and to allow them, through experience, to learn to apply their abilities and gradually improve the quality of their product.

The report expresses concern that a number of recent appointees as head of internal audit have not had any prior audit experience. While ideally, all such appointees would have audit experience, managerial skills and experience are of equal importance, and it is the government's concern that the best available person is appointed.

Overall, the government is in general agreement with the findings and recommendations proposed. While the government is satisfied that a number of the problems cited by the Auditor General have been, or are well on the way to being overcome, there is need for continued improvement.

This audit report confirms the need for the continuing efforts being carried out by the Office of the Comptroller General. These efforts are now focused on the quality of reports being produced, the implementation of audit recommendations, and the overall cost-effectiveness of internal audit across the government.

MANAGEMENT OF REAL PROPERTY

MANAGEMENT OF REAL PROPERTY

Table of Contents

Paragraph Page

Introduction 6.1 6–1

Audit Scope 6.14 6–4

Observations

Managing the Acquisition Process 6.25 6–6
  Needs and Requirements Definition 6.29 6–7
  Cases 6.34 6–8
  Project Management 6.39 6–9
  Information Management 6.40 6–9
  Appropriateness of Acquisition Choices 6.43 6–10

Managing Operations 6.46 6–10
  Space Utilization 6.47 6–11
  Cleaning 6.60 6–13
  Maintenance 6.61 6–13
  Risk Management 6.68 6–14
  Utilities and Energy Conservation 6.73 6–16

Portfolio Management 6.76 6–16
  Extent of Government Real Property Holdings 6.78 6–17
  Policy Objectives for Managing Real Property 6.94 6–19
  Compliance with Treasury Board Administrative Policy and Guidelines 6.96 6–20
  Policy Requirements for Monitoring the Efficient Use of Real Property 6.99 6–21
  The Significance of Cost Information on Economy and Efficiency in Managing Real Property 6.110 6–23
  The Significance of Opportunity Costs on the Efficient Use of Real Property 6.112 6–23
  Cases 6.116 6–24
  Undisclosed Subsidies 6.126 6–26

Conclusions 6.131 6–27

Recommendations 6.139 6–28

Exhibit

6.1 Distribution of Land by Department 6–2

6

MANAGEMENT OF REAL PROPERTY

Introduction

6.1 The management of real property is a complex subject. Real property involves more than land and buildings. It also includes other improvements and works such as roads, canals and runways. Real property is any right, interest or benefit in land, buildings and other improvements and works whether held through ownership, leasehold, easement, right-of-way or option.

6.2 The largest part of the Crown's inventory of land and buildings is held and managed by federal departments and agencies. These departments and agencies constitute the accounting entity of the Government of Canada. Its financial results are published in the Public Accounts of Canada.

6.3 The holdings of departments and agencies reported in the government's Central Real Property Inventory (CRPI) as of 31 March 1984 included 20 million hectares of land and 62,700 buildings (of which 5,400 are leased), comprising 24 million square metres of floor space. Although these assets are recorded in the Public Accounts of Canada at one dollar, their current value is estimated by the Treasury Board Secretariat to be between $40 billion and $60 billion.

6.4 In 1983-84, departments and agencies spent about $671 million acquiring land and buildings and about $454 million acquiring other improvements and works. About $10 million worth of real property was sold in 1983-84. Excluding expenditures on salaries and wages of public servants who are involved in the management of real property, annual expenditures for real property on grants in lieu of taxes, purchased materials and services for operations and maintenance, and rent were about $1 billion.

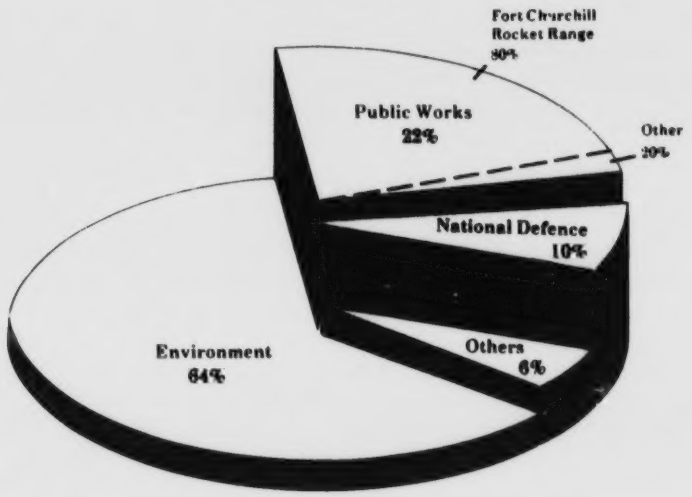
6.5 The balance of the Crown's inventory is held by Crown-owned corporations. The holdings of Crown corporations reported in the CRPI as of 31 March 1984 included 122,800 hectares of land and 7,400 buildings with 5 million square metres of space. However, some Crown corporations, including Canadian National Railways and Air Canada, do not report their real property holdings to the CRPI.

6.6 Responsibility for the management of real property is divided among several departments and agencies. The Department of Public Works (DPW) has the common service organization role for acquiring and providing office accommodation and for providing departments and agencies with real property acquisition and management services. However, there are several other departments, including the Department of National Defence, the Department of Transport, the Department of Indian Affairs and Northern Development and the Department of the Environment, that have extensive real property

Exhibit 6.1

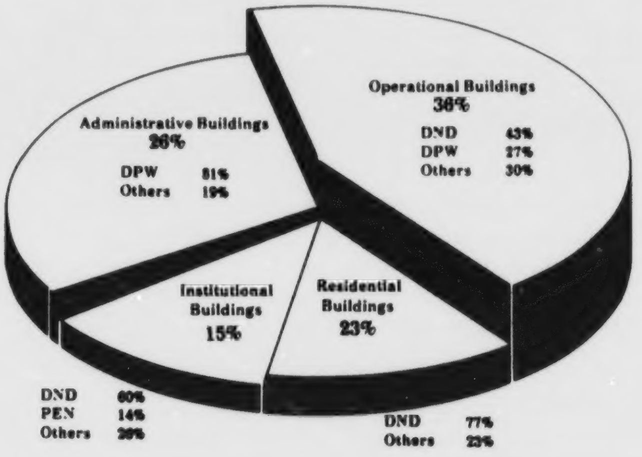
DISTRIBUTION OF LAND BY DEPARTMENT

(20 Million Hectares)



DISTRIBUTION OF BUILDING FLOOR AREA BY TYPE OF BUILDING AND BY DEPARTMENT

(24 Million Square Metres)



Source: Central Real Property Inventory

holdings and also acquire and manage real property. The Department of Public Works also pays grants in lieu of taxes and is responsible for managing or selling real properties declared surplus by departments and agencies under the Surplus Crown Assets Act. The government does not explicitly mortgage its real property. However, some of the interest on the national debt, which is the responsibility of the Department of Finance, could be attributed to the acquisition of specific real properties.

6.7 Departments are responsible for ensuring efficient compliance with the administrative policies issued by the Treasury Board. The Office of the Comptroller General is responsible for establishing standards for internal audit and for reviewing the effectiveness of internal audit practices in departments. The Treasury Board Secretariat is responsible for evaluating the effectiveness of administrative policies and for developing new policies or revising existing ones.

6.8 The government's key policy statement on the management of real property is Article .1.1 of Chapter 110 of the Treasury Board's Administrative Policy Manual which states:

> It is the policy of the government that federal real property be managed economically and efficiently and that it be managed so as to combine the efficient provision of government services with the achievement of wider social, economic and environmental objectives.

6.9 A significant component of decision making on acquiring, operating and disposing of real property is an assessment of how best to implement the three objectives outlined in this policy statement.

6.10 **Economy in the acquisition of real property.** The Office of the Comptroller General has defined economy in its Standards for Internal Audit as follows:

> Economy refers to the terms and conditions under which resources of all kinds (personnel, materiel, equipment, land, buildings, etc.) are acquired. An economical operation acquires the resources necessary for the operation in appropriate quantity and quality at the lowest possible cost. Thus, economy deals with acquiring resources. It is concerned with quantity, quality and price of resources purchased.

6.11 In the case of real property, for example, "lowest possible cost" implies the lowest cost over the useful life of an asset rather than the lowest initial price or lowest current expenditure. Appendix A to Chapter 110 of the Treasury Board Administrative Policy Manual points out the requirement for life-cycle costing in the management of real property.

6.12 **Efficiency in the use of real property.** Similarly, the Office of the Comptroller General has defined efficiency in its Standards for Internal Audit as follows:

> Efficiency refers to the relationship between goods or services produced and resources used to produce them. The efficiency of a government program or operation depends on how well resources of all kinds (human, materiel, equipment, buildings, etc.) are used to produce the goods and services necessary to accomplish a program's objectives. An organization is most efficient when it produces the largest possible output for a given amount of input (resources) or when the organization meets its goals while incurring the least cost.

6.13 This definition notes that efficiency depends on how well resources of all kinds are used. This implies that all applicable costs are to be considered in assessing efficiency.

Audit Scope

6.14 The objective of this audit was to determine whether federal departments and agencies give due regard to economy and efficiency in managing real property.

6.15 We examined management of land and buildings by federal departments and agencies as well as government information on lands entrusted to Canadian National Railways and on lands granted to the Canadian Pacific Railway which could revert to the government under certain circumstances.

6.16 Real property associated with the federal government's non-military activities outside Canada is acquired and managed by the Department of External Affairs. In 1982, as part of our audit of Foreign Operations, we reported on the management of the Department's portfolio of Crown-owned and leased properties. We have therefore excluded these real property activities from the scope of this audit. In 1983, as part of our audit of Parks Canada, we reported on managing new park acquisitions and development. Consequently, we have excluded national parks and historic sites, except for townsites.

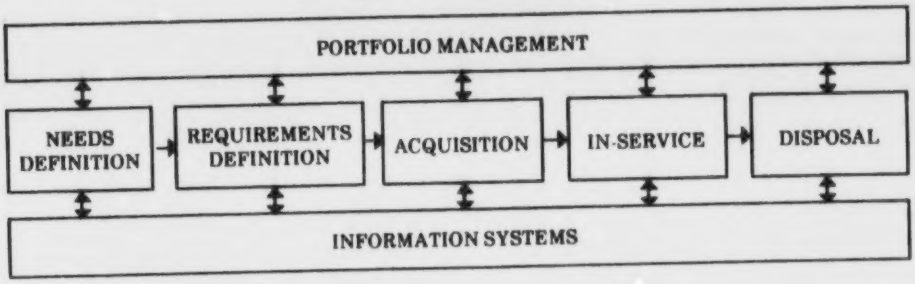
6.17 We did not examine the following areas:

- real property activities of Crown corporations;
- improvements such as roads, canals and runways;
- Indian lands; and
- Territorial land not set aside for use by a department or agency.

6.18 Because of the extensive real property holdings of DPW and its common service organization role in real property management, this audit was closely co-ordinated with the comprehensive audit of DPW, which is reported in Chapter 13.

6.19 **Life cycle stages.** In our 1980 Report, we defined five stages in the life cycle of materiel. These stages also apply to the life cycle of real property.

Life Cycle of Real Property



6.20 Although we examined all life cycle stages, we amalgamated some of them for presentation purposes:

- the acquisition process (needs definition, requirements definition and acquisition stages);
- the operation of buildings, including the use of space (in-service stage); and
- the management of the portfolio of real property assets, including the disposal of properties when appropriate (disposal stage).

6.21 Our observations are based on the examination of specific life cycle stages for a sample of 130 different real properties consisting of buildings and vacant lands. These properties were selected to be representative of the government's inventory of real property in terms of the following characteristics:

- proportion of owned versus leased properties;
- proportional size of departmental holdings;
- types of buildings (administrative, operational, residential and institutional);
- age of buildings; and
- geographical distribution of properties within Canada.

6.22 **Audit criteria.** In addition to using our previous materiel management audit criteria, published in 1980, our assessment of real property management practices was based on criteria drawn primarily from Treasury Board administrative policy directives and guidelines. As appropriate, we also used departmental policy to expand our interpretation of more generally stated Treasury Board directives and guidelines.

6.23 Our specific observations are reported in the next section, Observations. We examined the economy with which real property is acquired under the heading of Managing the Acquisition Process. We examined the efficiency with which buildings are operated in terms of space utilization and in terms of property management (maintenance, cleaning, etc.) under the heading of Managing Operations. Finally, under the heading, Portfolio Management, we examined the concepts of economy and efficiency in respect to the function of real property management, including the efficiency with which real property is used, and the contribution of the use of real property to the achievement of wider social, economic and environmental objectives.

6.24 The Conclusions and Recommendations sections consolidate our specific observations and set out our conclusions and recommendations with respect to the entire real property management function.

Observations

Managing the Acquisition Process

6.25 The government acquires real property by leasing and lease-purchase methods as well as by purchase and construction. In this section, we report on our examination of the acquisition of land and buildings by purchase and construction. The comprehensive audit of the Department of Public Works (Chapter 13) reports on the acquisition of real property by lease and lease-purchase methods.

6.26 In 1978, we reported on the planning of 13 capital acquisition projects, 5 of which involved the acquisition of real property. At that time, because of a lack of appropriate cost information and effective controls, we concluded that the government's capital acquisition process did not come up to a reasonable standard of due regard for economy. We also noted that, although the Treasury Board's policy directives and guidelines on the management of major Crown projects largely met our criteria, it was too soon to assess their effect.

6.27 In 1979, as part of the comprehensive audit of DPW, we examined nine projects that involved acquiring general purpose office accommodation. We reported that eight of the nine projects did not demonstrate a reasonable standard of due regard for economy.

6.28 In this audit, we examined 20 capital construction projects. Fourteen of the projects selected were undertaken by DPW either for itself or on behalf of client departments. Two DND projects under $5 million were selected to complement the 12 capital construction projects examined as part of the comprehensive audit of DND (Chapter 12). We also chose four projects involving expansions to airports undertaken by the Department of Transport. To assess the impact of current Treasury Board policy directives and guidelines, we chose projects just recently completed or nearing completion.

Needs and Requirements Definition

6.29 Treasury Board's policy directives and guidelines on acquiring real property and managing major Crown projects provide direction for the acquisition process. Additionally, the departments that acquire real property – notably Public Works, National Defence and Transport – have developed detailed project delivery systems and procedures. These are based generally on Treasury Board administrative policy. However, despite these policies and procedures, difficulties in translating real property needs into specific project requirements, as well as unexpected changes in these needs, have at times caused delays and resulted in increased costs.

6.30 A component of the need for real property can sometimes be the achievement of wider government objectives. The Treasury Board Administrative Policy Manual sets out how these wider needs are to be considered:

> Where the achievement of wider social, economic and environmental objectives requires funding additional to that provided for the requirement either under the same authority as the funding for the requirement or separately, departments shall identify the objectives and the funding for them separately throughout the analytical and decision-making processes and in any submissions to the Treasury Board.

6.31 The effect of this directive is to require departments, first, to conduct their analyses of proposed acquisitions of real property as if economy and efficiency were the sole determinants to decision-making. Then, separately, departments are required to describe specifically the wider objectives to be achieved and to estimate the additional costs.

6.32 In general, we found little evidence that managers analyse the costs and benefits of contributions to wider social, economic and environmental objectives when acquiring real property. One partial exception we found in our sample was the analysis provided by National Revenue - Taxation to Treasury Board for the decentralization of Taxation Data Centres. The extra cost of the Government's decision to construct six regional Taxation Data Centres was clearly identified in the analysis. In addition, estimates were made of the number of jobs to be created in each of the proposed Centres.

6.33 In 13 of the 20 acquisition projects examined, where we found that the needs definition had been adequately developed and documented, the acquisition process was able to proceed readily from the project requirements definition stage to the preparation of designs and specifications. These projects were delivered close to expected time, cost and quality requirements. However, in the other seven projects, the needs had not been adequately developed and documented. This, in turn, hampered clarification of requirements and ultimately resulted in a combination of project delay, additional cost and facilities that do not fully meet operational needs.

Cases

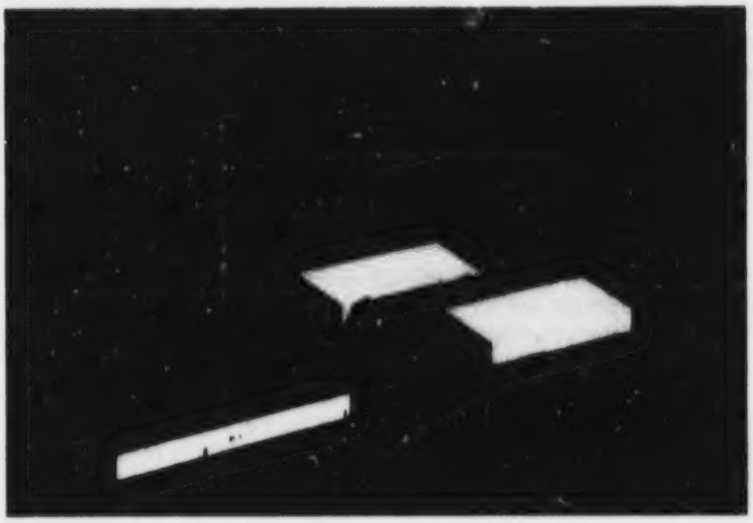
6.34 The following two cases illustrate the general problems which can result from inadequate needs definition.

6.35 **Drummond Institution at Drummondville, Quebec.** This institution was constructed by DPW for the Correctional Service of Canada. The need for a small, medium security institution of 150 inmates was originally identified in 1973. Between 1973 and 1979, when the actual requirements for the facility were approved, considerable time and effort were expended in reassessing the need, relocating the site between Ste-Anne des Plaines and Drummondville, and changing the size and security level of the proposed institution.

6.36 Work on the site was halted for about four months in late 1978 pending approval of a five-year accommodation plan. The project was deactivated from mid-1979 to mid-1980. Construction on the site recommenced in 1981 with an approved budget of $34.3 million, an amount that did not include the costs of previously completed design work. To provide for an expanded inmate population, Treasury Board approved a budget increase in May 1983 of $2.2 million for an additional 42-cell living unit, an option that had been allowed for in the design. In June 1984, Treasury Board approved a further budget increase of $4.4 million to cover the costs of work completed in the 1970s, and to cover additional engineering costs because a phased construction program had been adopted. At the time of our audit, the institution was scheduled to be completed in the fall of 1984, an elapsed time of 11 years from when the need was first identified.

6.37 **2100 Walkley Road, Ottawa.** In 1981, the Department of National Defence acquired a building in Ottawa for about $2.1 million to consolidate several Militia units. The building was privately owned but was on land leased from the National Capital Commission. This acquisition did not follow normal departmental procedures in that it was undertaken without a clear definition of specific Militia unit needs or a comprehensive estimate of the cost to renovate the existing building. National Defence took this action to take advantage of the building's availability. At the time of this audit, the building was vacant, and the Department of National Defence did not have an approved project proposal for its future use, although this was being processed.

6.38 The National Capital Commission is now charging the Department of National Defence for the cost of renting the land – currently about $46,000 a year. Adding this to the cost of money used to purchase the building at an assumed interest rate of 10 per cent, the total cost to the government of this property over the last three years has been about $770,000.



Ottawa building acquired in 1981 for Militia units.

Project Management

6.39 In most of the projects examined, the accepted norms for project management were followed. The standard of project management was significantly advanced over that noted in 1978 and 1979. In general, the project management organizations and relationships were established early in the life of each project.

Information Management

6.40 In our 1978 audit of planning for capital acquisition projects, we reported that the estimated costs of operating and maintaining assets over their useful lives were not used in planning projects. During the current audit, we found that decisions are still being made on building materials and systems without adequate information on life cycle costs. It is essential that appropriate data on the costs of operating and maintaining buildings of various types are obtained and used when planning and designing new buildings, as well as in the day-to-day management of existing buildings.

6.41 In our review of the Sudbury Taxation Data Centre construction project, we found that $1.6 million worth of work had been deleted from the project during the assessment of the tenders and prior to awarding the contract. The reduction involved several items, including the substitution of lower-cost materials and finishes and a reduction in parking space. There was no evidence, however, of any life cycle cost analysis carried out during the selection of the specific deletions.

6.42 In all projects examined, there was a lack of cost and performance data. We noted, for example, that the Department of Transport uses standard cleaning and maintenance task frequencies and time data to forecast cleaning and maintenance workloads in existing and new airports. However, the Department's cost accounting system does not break down cleaning and maintenance costs by major functional areas within airports. Consequently the standards cannot be verified against actual practice. This hampers forecasting costs and the ability to consider the efficiency of alternative designs and materials for specific functional areas.

Appropriateness of Acquisition Choices

6.43 Treasury Board's Administrative Policy Manual states that leases are generally more appropriate for short or medium-term occupancies and ownership is generally more appropriate for long-term occupancies. The Department of Public Works, however, leases a number of buildings, particularly in the National Capital Region, for long periods for continuing occupancies. In Chapter 13, we report that the additional costs to the Crown from 12 leasing transactions we reviewed as part of the comprehensive audit of DPW will amount to $63 million over the term of the lease, partly a result of the Department's failure to comply with directives and guidelines on leasing real property.

6.44 The comprehensive audit of DPW also included an examination of eight acquisitions using the lease-purchase method. For four of the eight lease-purchase arrangements we report on in Chapter 13, we concluded that the additional financing cost will be approximately $86 million, $14.9 million on a present-value basis, over the term of the lease-purchase arrangements. In the Department's opinion, some of the excess cost can be offset by the potential benefit in having the developer assume the risks during construction (that is, delivery on time and within budget) as compared to Crown-construct (financed) projects.

6.45 As of 31 March 1984, the total principal and interest still outstanding to finance the eight lease-purchase arrangements was about $1.6 billion. The capital nature and costs of these transactions have not been reported to Parliament. The Department of Public Works states that its current practices conform to prescribed government accounting practice and that future Main Estimates (Part III) will fully display all construction and financing costs associated with lease-purchase projects. A recommendation for the disclosure of information to Parliament on lease-purchases is made in Chapter 13.

Managing Operations

6.46 The operation of buildings includes both space utilization and day-to-day property management activities. The occupants of buildings should be concerned with economical use of space; that is, having sufficient space of acceptable quality at the lowest cost. Property management involves cleaning, maintenance, and providing utilities and security services, including minimizing risks. These services are usually provided by or on behalf of the property owner to satisfy the building occupants, maximize profits and preserve the value of the building.

Space Utilization

6.47 We examined whether departments ensure that their space needs are adequately defined and their use of space is adequately monitored and controlled. In the case of office space, we examined whether departments comply with the Treasury Board Office Accommodation Control Standard which sets maximum space allowances. Departments are required to obtain Treasury Board approval to exceed the Control Standard.

6.48 **Office accommodation.** The Department of Public Works provides most departments with general purpose office accommodation at no charge. These departments do not have to budget or account for the cost of their office space. Furthermore, they have little information on the cost of the space they use and little incentive to keep the quantity or quality of such space within reasonable limits. Public Works' target for the implementation of revenue dependency means all departments should begin paying rent for the space they occupy beginning April 1986.

6.49 The Treasury Board office accommodation policy explicitly states that the Office Accommodation Control Standard is not to be treated as an entitlement but as a maximum. We found that, when requisitioning new or additional office space, departments used the Control Standard as a minimum entitlement. Further, they frequently did not obtain Treasury Board approval to occupy space that exceeded the Control Standard.

6.50 In the case of using existing office space, there has been general disregard of the Treasury Board's office accommodation policy. Departments have neither adequately monitored nor controlled their use of office space and have not obtained Treasury Board approval for or advised DPW of their use of office space that exceeds the Control Standard.

6.51 A recent DPW study of use of office space estimates that, government-wide, the amount of excess office space is between 152,000 and 305,000 square metres. The Department estimates that this space has an annual rental value of about $120 per square metre.

6.52 The Central Real Property Inventory reports that the government has about 3,300 Crown-owned and leased office buildings with 7.2 million square metres of office space. We examined the use of about 440,000 square metres of office space (approximately 6 per cent of the total office space) in 30 of these buildings. Approximately 56,000 square metres, or about 13 per cent of the total space examined, was in excess of the Control Standard and had not been approved by the Treasury Board. This excess space has an annual rental value of approximately $9 million.

6.53 The Department of Public Works occupies the Sir Charles Tupper Building as its Headquarters in Ottawa. The Department is allowed a maximum of 16,740 square metres of office space under the Control Standard. However, it occupies 20,850 square metres of office space, 4,110 square metres in excess of the Control Standard. Treasury

Board approval for this excess space, which has an annual rental value of about $448,000 a year, had not been obtained.

6.54 At the National Defence Headquarters Building in Ottawa, space occupied by DND exceeds the Control Standard by roughly 23 per cent or 11,500 square metres. At a cost of $175 per square metre, this excess space corresponds to a rental value of about $2 million per year. The Department had not obtained Treasury Board approval for this excess space. It is possible that various DND units which are accommodated in a number of other buildings in Ottawa and Hull, some of them leased, might be able to use this excess space. National Defence has formed a Facilities Development Task Force to examine the Department's use of space and to develop a long-range accommodation plan for the National Capital Region.

6.55 **Residential accommodation.** We looked at the living unit vacancy rates in 15 residential complexes, most of which are on Canadian Forces Bases. We found that married quarters managed by DND are frequently vacant for periods in excess of 30 days because of the length of time it takes the Department to prepare units for new occupants. Although factors such as the age of the units, the lack of a central focus for management of married quarters, and the large annual turnover of married quarters within a short posting period contribute to this time, the Department believes that it is excessive. In addition, reductions in Base operations or competition from private sector landlords have resulted in large numbers of married quarters being vacant for extended periods of time. At Canadian Forces Base Gagetown alone, 349 units were vacant due to lack of demand.

6.56 The annual report on government living accommodation prepared by the Treasury Board Secretariat estimates that the amount of rental revenue lost in 1982-83 due to all vacancies in living accommodation, including vacancies in National Defence married quarters, was about $16.9 million. The report does not provide information on the costs of maintaining vacant units.

6.57 **Operational and institutional buildings.** In operational and institutional buildings, we found few problems with the use of space to which there were economical solutions. In many instances, these problems involved adapting older buildings to changing needs, work processes, technology, and so on. For example, the current station hospital for Canadian Forces Base Cornwallis, Nova Scotia, which has a need for 35 beds, is housed in a 200-bed, World War II frame hospital building. Although areas assigned to the various hospital functions exceed current norms, there does not appear to be a more economical use for this facility.

6.58 For several newer buildings, we found that the needs which the buildings were designed to meet had not developed to the extent or as rapidly as forecast. For example, the National Research Council has a Fire Research Field Station just outside Ottawa that was completed in 1980 at a cost of about $3.5 million. It is used at only about 50 per cent of its capacity, despite attempts to make the facility available to other potential users. Part of the reason for the low level of use was attributed to a constraint on funds for fire research projects.

6.59 The Department of National Defence completed its "Megastructure" building project at Canadian Forces Base St-Jean, Quebec, in 1982 at a cost in excess of $100 million. The building is about evenly divided between language and other training functions. The living quarters space allocated to those taking language training was originally designed to accommodate 1,600 language students. A decision was taken during construction to reduce the student loading of classrooms, which reduced the overall accommodation requirements to about 1,000 students. Since the Department began to occupy the building in 1979, the average occupancy level for living quarters allocated to those taking language training has been only about 600 students.

Cleaning

6.60 In general, the buildings examined in this audit were cleaned to the satisfaction of the occupants. Where contract cleaning services were used, the costs tended to be consistent with local norms. Departments are aware that contract cleaning can provide savings and are converting where attrition and redeployment of staff and other circumstances permit.

Maintenance

6.61 For most of the buildings examined in this audit, there was some system for scheduling and controlling maintenance. The departments with significant real property holdings, such as DPW and DND, had developed and documented internal policies and procedures on property management. A number of other departments were in the process of developing policies and procedures.

6.62 We found an expressed concern by building managers that reductions in staff and maintenance budgets were causing postponement or reduction of preventive maintenance, resulting in potentially higher maintenance and repair costs in the future and the attendant loss of value in the asset. There has been little study, however, to determine the nature or magnitude of the actual problem, if any, and the corrective action necessary. There are no commonly accepted standards for measuring the quality of building maintenance or the condition of a building, and research on this subject is hampered by the absence of adequate cost data for operating and maintaining government buildings. The absence of such data is referred to many times in this chapter and has been an area of concern for over 20 years.

6.63 DPW completed a study of the condition of structural, mechanical and life safety systems in 39 Crown-owned buildings in February 1984. The study concluded that for 10 of these buildings, the systems were less than adequate, and maintenance was deficient. The National Revenue Building in Hamilton, as an example, had not been adequately maintained. The roof was in a state of advanced deterioration; complete re-roofing was essential. Mechanical and electrical systems were in a poor state of repair, and maintenance and life safety systems met only minimum requirements. In general, the building did not reflect a satisfactory level of maintenance. At the time of our audit, DPW was analysing the findings of the study.

6.64 The Department of National Defence bases its building maintenance budget on 1.8 per cent of the replacement value of its buildings. Although actual budgets in recent years, with the exception of 1977-78, have not reached this level, it is not apparent what impact this has had on the maintenance condition of buildings.

6.65 A maintenance standard is assigned to each building that reflects DND's planned future use for the building. A composite index is used to measure how closely the actual maintenance of buildings corresponds to the assigned maintenance standard. While the system can distinguish between over-and under-maintenance, the level of efficiency in reaching the specific maintenance standard is not measured.

6.66 The implementation of an automated system to identify operation and maintenance costs by individual facilities is scheduled for this fiscal year. This should allow correlation of indices to corresponding resource allocations and, accordingly, will denote better if a low level of maintenance is indicative of insufficient maintenance funds.

6.67 Although efforts are made by departments to keep track of expenditures on operating and maintaining buildings, there was little evidence that they have adequate cost information. For example, although direct salary costs are usually accounted for, costs of fringe benefits and other items are not charged to the cost of a specific job. This prevents any reasonable comparison with the cost of contracted services or with industry standards and makes it more difficult to identify and eliminate inefficiencies.

Risk Management

6.68 Risk management is concerned with all aspects of the security of a building and its occupants. Since the government follows a policy of self-insurance, it is particularly necessary that risks associated with fire, vandalism, and so on are identified and analysed and that appropriate action is taken to reduce to acceptable levels the risk of loss of property and life. Generally, the written procedures for managing risk are comprehensive, and efforts to identify and control risk are of a high order.

6.69 There are some problems, however, in terms of the adequacy of inspection procedures and follow-up. For example, for the 43 Crown-owned and leased buildings held by Public Works that we examined, 11 of the 28 Crown-owned and 7 of the 15 leased buildings had either not been examined on schedule by the Fire Commissioner of Canada or had fire or other safety deficiencies that were outstanding. For instance, a complete inspection of the fire protection system in the C.D. Howe Building, although required annually, had not been carried out since 1979.

6.70 We were advised that the Regional Fire Commissioner for the National Capital Region has 5 inspectors to carry out inspections in 3,000 buildings. In 1982-83, these inspectors examined about half of the space scheduled for inspection. The Department of Pubic Works claims that about 90 per cent of the space scheduled for inspection would have been examined had the Regional Fire Commissioner not had to respond to a large number of requests for unscheduled inspections. These amounted to about forty per cent of the space scheduled for inspection.

6.71 In some cases, it took an inordinate amount of time to correct safety deficiencies. For instance, the Regional Fire Commissioner for Whitehorse first recommended in 1976 that the Department of Transport air terminal building install either a sprinkler system or special fire-resistant enclosures to separate aircraft and public areas. This deficiency was noted again in the Fire Commissioner's reports in 1979 and 1982. The Department of Transport advised that no action would be taken now because a new air terminal building is under construction.

Storage area for hazardous and toxic chemical wastes, Animal Diseases Research Institute, Ottawa.

6.72 In another case, although fire and physical security were adequate, the operations carried out in the Department of Agriculture's Animal Diseases Research Institute building in Ottawa, coupled with inadequate design or maintenance of air and waste handling systems, represent a danger to building occupants. These problems were identified in 1981 in a report prepared for the Department of Public Works which manages the building. In 1982, the Regional Fire Commissioner also recommended immediate action to improve the storage area for hazardous and toxic chemical wastes. Temporary work has been done to meet the immediate requirements, and planning is under way for permanent solutions.

Utilities and Energy Conservation

6.73 In 1980, we reported that Public Works, National Defence and Transport had developed a planned and phased approach to energy conservation. In this audit, we found that the policies, standards and procedures developed to reduce energy consumption in federal buildings are comprehensive, and the annual level of energy consumption in many of the federal buildings we examined has been reduced. However, some potential for energy conservation may still exist. For example, 45 per cent of the Crown-owned buildings that we examined have not yet had an energy survey which could identify specific further measures that could be taken to reduce energy consumption.

6.74 Public Works has implemented a comprehensive program for energy conservation in existing Crown-owned buildings and heating plants. However, all leased and lease-purchased buildings have not yet been included in this program, although plans have been developed. The C.D. Howe Building in Ottawa is an example of potential foregone energy savings in a lease-purchased building. Although a January 1983 energy survey of this building identified potential energy savings of $200,000 annually for a one-time cost of $100,000, DPW's National Capital Region has no plans to follow up this report because the building is lease-purchased. In all other respects, however, the building is managed as if it were Crown-owned.

6.75 The Department of National Defence has put meters in most of its married quarters to charge occupants for energy used and encourage energy conservation. Many of the Department's non-residential buildings, however, are not equipped with meters. This hampers identification of buildings which are high energy users and measurement of the effectiveness of any energy conservation initiatives taken. In view of the high costs of metering individual buildings, DND has initiated a study to determine the most cost-effective method of measuring energy conservation initiatives.

Portfolio Management

6.76 We define portfolio management as managing a portfolio of real properties through "decision rules" that determine the environment within which decisions on individual properties are made. These decision rules may be formal and appear as policy directives and guidelines, or they may be informal, deduced by managers from the characteristics of decisions taken by their superiors. The decision rules may encompass objectives, administrative processes, delegation of authority, operating plans and budgets – in general, the basis upon which managers are to be held accountable. The most important decision rules for an organization to define in managing its real property portfolio are those that define the organization's objectives.

6.77 The Treasury Board has formally issued decision rules in its Administrative Policy Manual, the Guide on Financial Administration and several other documents, mainly with respect to individual transactions. It has also formally defined a "control framework" by which its administrative policy directives and guidelines are to be monitored. The control framework for the management of the federal government is set out in Treasury Board's Administrative Policy Manual. In brief, the Treasury Board Secretariat is responsible for administrative policy development; departments are responsible for internal administrative control procedures; and the Office of the Comptroller General sets standards to be used by departmental internal audit units in auditing operations. The policies and the control framework in which they are set out should not only enable but should ensure that due regard is given to economy and efficiency.

Extent of Government Real Property Holdings

6.78 Management of an entity's portfolio is not possible without a reasonably accurate knowledge of its holdings. The Central Real Property Inventory (CRPI) maintained for Treasury Board by DPW provides limited information on most federal real property holdings. This information includes location, holding department, size, original cost and identification of the occupants.

6.79 Departments state that they seldom, if ever, use the CRPI. The primary reasons cited included the Inventory's inaccurate and incomplete data. The quality of information in the CRPI is dependent on the quality of information provided to DPW by departments and agencies. Although errors and omissions are being corrected as they are identified, there is inadequate departmental control to ensure that complete and accurate records of real properties are maintained.

6.80 In general, however, departments claimed to have little need for information on the real property holdings of other departments and they tend to rely on their own information systems for data on their own holdings. The primary use we identified for the CRPI was the initial identification of federal real properties in areas scheduled for studies by the Area Screening Canada program, discussed later in this chapter. Even in these cases, reference is eventually made to departmental real property inventory systems to identify holdings more completely.

6.81 Three categories of real property that are not included in the CRPI are entrusted railway lands; Ordnance, Admiralty and Dominion lands; and lands with reversionary interests. The following three cases illustrate the information available on these properties.

6.82 **Lands entrusted to Canadian National Railways (CN).** The Canadian National Railways Act of 1919 gave the government the power to entrust the management and operation of certain lands to CN. According to an inventory prepared by CN in 1979, the entrusted lands total some 32,800 hectares. In 1980, the Department of Transport reported that the total value of the entrusted lands and railway equipment was $820 million. That report did not provide separately the value of the lands and equipment.

6.83 The Governor in Council may set conditions governing the use of the entrusted lands and may reclaim them at any time. However, with a few exceptions, the Orders in Council entrusting the properties to CN have not imposed any conditions or restrictions on the use that CN may make of these lands, nor have they specified any conditions under which the lands must be returned. According to the Department, the statutory entrustment does not provide it with any authority, control or accountability over the use and management of Canadian Government Railway lands independently from the powers of the Governor in Council, except for the annual review by the Department of CN's corporate plan and capital budget.

6.84 CN's 1979 inventory described, in very general terms, the lands entrusted to it. Included among the properties are: 20 hectares in Quebec City, described as "commercial and residential sites"; 2 hectares in Chatham, New Brunswick, described as a "shopping centre complex"; one hectare in Halifax, described as a "lease to City of Halifax for Park"; and 405.5 hectares described simply as "industrial leases". Because the management of real property by Crown corporations was outside the scope of our audit, we have not verified the uses made of these properties or verified any other information contained in the CN report.

6.85 According to the Department of Transport, CN has been required since 1977 to transfer proceeds from the sale of entrusted railway lands to the Consolidated Revenue Fund. Further, CN has to request letters patent from the government before it can transfer title to a purchaser. The Department of Transport now reviews all proposed disposals and leases of entrusted land. The Department usually relies on CN's appraisals of the properties as a basis for setting prices.

6.86 **Ordnance lands.** Under the Constitution Act, 1867, Ordnance and Admiralty lands, used initially by the British military administration, were vested in the federal Crown. Dominion lands include those purchased by Canada in 1869 from the Hudson's Bay Company and retained by the federal government when the western provinces were created. For simplicity, Ordnance, Admiralty and Dominion lands will be referred to here as Ordnance lands. The Department of the Environment, which took over responsibility for Ordnance lands about 10 years ago, estimates their value is about $10 million.

6.87 Records of Ordnance lands are poor. Few of these properties were accurately described, and the chain of title for most of them can only be traced with difficulty. Some lands have been taken over by squatters or have been encroached upon by owners of neighbouring lands. As prescriptive rights after 1890 can no longer be acquired against the Crown, it is probable that the Crown still retains legal interest in many of these properties.

6.88 Parks Canada recently searched the titles and carried out surveys of Ordnance lands along the Rideau Canal system to assist in developing the area for recreational purposes. Although the purpose of the study was not directly to recover Crown property or to rectify errors or inconsistencies between legal ownership and actual occupation, the research identified a number of government properties which it did not know it owned and on which other persons have squatted or encroached.

6.89 The study of the Rideau Canal lands proved useful in identifying valuable Crown-owned lands and in clearing title problems. However, no ongoing research is being carried out or is planned on the balance of the 4,000 files on Ordnance lands. Only when specific inquiries arise does the Department of the Environment refer to its archival files to determine the origin, nature and approximate value of the Crown's interest. Moreover, no attempt has been made to assess whether the potential benefits of such research would outweigh its costs.

6.90 **Reversionary interests under the National Parks Act.** In December 1980, the Department of Justice advised Parks Canada that the Crown had a reversionary interest under the National Parks Act in certain lands situated in the Banff National Park townsite and owned by Canadian Pacific Railway (CPR). The property is part of the former CPR station grounds. It consists of several hectares in downtown Banff and, based on appraisals of similar properties in Banff, it has a value of over $1 million.

6.91 According to the Department of Justice, the property, although owned by the CPR, is subject to a reversionary interest on the part of the Crown pursuant to section 6 of The National Parks Act, which states that if any lands in Federal Parks granted for "right-of-way or station grounds cease to be used for that purpose, they shall revert to the Crown". Parks Canada sought and obtained a legal opinion after CPR proposed to build rental accommodation on the property. To date, Parks Canada has not taken measures to obtain the reconveyance of this land to the Crown.

6.92 At present, the Department of the Environment does not have an inventory of those lands in the National Parks that may be subject to the Crown's reversionary interest. The Department has carried out a partial search of the titles to the land in Banff National Park but has not completed it. No other Parks lands have been researched.

6.93 The Department knows neither the location nor the value of the "reversionary" lands in the National Parks. Without this information, it is unable to monitor the use made of this land and is not in a position to reclaim land that may no longer be needed for railway purposes.

Policy Objectives for Managing Real Property

6.94 Article .1.1 of Chapter 110 of the Treasury Board Administrative Policy Manual, quoted earlier in this chapter, sets out the government's policy objectives with respect to managing real property. These policy objectives call for managers to exercise due regard for economy and efficiency in the management of real property. We found that the framework of administrative policy directives and guidelines was generally consistent with these policy objectives.

6.95 The intent of Article .1.1 is reinforced by the Treasury Board's 1983 publication, Principles for the Management of the Public Service of Canada. It states that managers are responsible for realizing the productive potential of all resources entrusted to them and for optimizing program economy, efficiency and effectiveness through prudent management. In executing this responsibility, managers at all levels are accountable for providing information and advice that is timely, thorough and objective and that lays out alternative courses of action available within the law.

Compliance with Treasury Board Administrative Policy Directives and Guidelines

6.96 A monitoring process is required to determine both the level of compliance with policies and the need for changing them. The Treasury Board's Control Framework describes how compliance should be monitored. However, the Control Framework has only been partially implemented. Managers are not held accountable for applying or adhering to the administrative policy directives and guidelines of the Treasury Board as they relate to the management of real property.

6.97 Until recently, there has been little monitoring of administrative policy to assess either the level of compliance or the workability of the policy. In 1983, the Treasury Board conducted a review of departmental internal audit reports from 13 departments on the management of real property and summarized its findings as follows:

- There was a lack of departmental directives and guidelines on the assignment of responsibilities for the real property management function.
- There was no process to ensure adherence to the government's policy on the management of real property; departmental property records were not up to date and, consequently, the CRPI could not be up to date.
- The monitoring processes supporting property management information were generally weak and were carried out only infrequently.
- Responsibilities for establishing the quality, level and standard of maintenance of facilities were not clear.

6.98 These findings are consistent with our own. The Treasury Board and departmental audit units have made some progress in assessing the level of compliance with policy directives and guidelines on the management of real property.

Policy Requirements for Monitoring the Efficient Use of Real Property

6.99 The Treasury Board Secretariat estimates that the current value of the government's real property holdings is between $40 billion and $60 billion. The material significance of these assets should focus attention on the need for due regard to economy and efficiency in their management and use. It should also focus attention on the need for an estimate of the current value of those properties that could be:

- more fully used to meet additional government needs;
- redeveloped to generate additional revenue while still meeting the government's current needs; or
- sold because they are surplus to needs.

6.100 This is implicitly required by the Federal Land Management Principle stated in Article .2 of Chapter 110 of the Treasury Board Administrative Policy Manual. In addition, it would ensure that accommodation was provided efficiently.

6.101 **Departmental review of real property.** Departments are required to take into account wider government objectives in their continuing use of the real property they manage and control. Article .2 of Chapter 115 of the Treasury Board Administrative Policy Manual focuses on the government's three policy objectives:

> Departments shall periodically review the use of the lands of which they have administration and control or right to use. These reviews should address the use of land from the viewpoint of three fundamental objectives:
>
> - the efficient fulfilment of the requirement and, through this, the efficient provision of government services,
> - the efficient use of federal real property, and
> - the achievement of wider social, economic and environmental objectives.

6.102 Departments have not fully complied with this directive. The Departments of National Defence and Public Works have processes for the periodic review of the property they manage and control. DND has a Base Development Planning function, and DPW has an Area Planning function. In both Departments, the extent to which this policy directive is carried out varies. Most Canadian Forces Bases have Base Development Plans. Public Works has Area Plans for most major cities. Both functions focus on the efficient fulfillment of the requirement but, to a lesser extent, on greater land-use efficiency. The cost of contributions to wider social, economic and environment objectives, however, is usually not addressed. Neither function adequately addresses the efficient use of the real property involved, in terms of the economic value of the land for alternative uses.

6.103 All departments we examined had some sort of system to support the day-to-day management of real property. The systems used by occupants of real property, however, do not monitor for and ensure compliance with the Treasury Board Office Accommodation Control Standard. Also, the systems used by property holders do not include information on current value, where appropriate, condition and costs, or potential for expanded use. Thus they could not be used by departments to determine the most appropriate use of their property.

6.104 **The Area Screening Canada Program.** The Treasury Board Advisory Committee on Federal Land Management (TBAC/FLM) is responsible for monitoring significant real property transactions to ensure that they are consistent with the Federal Land Management Principle.

6.105 DPW, as an agent of the Treasury Board, carries out the Area Screening Canada program. Through this program, DPW is responsible for identifying and reporting to the TBAC/FLM on properties that have potential for improved use. The Area Screening Canada program has undergone considerable evolution since the Standing Senate Committee on National Finance commented on it in 1978. As the Committee recommended, the program now includes regular review of properties for under-utilization. The form of its report has evolved considerably between 1978 and 1984, and it now focuses more sharply on the use of individual properties. However, the program is not required to conduct economic analyses of development alternatives, and DPW produces no such assessments.

6.106 Since 1977, Public Works has completed 47 Area Screening studies of major urban centres. Each study has taken over two years to complete, one reason being the need for substantial consultation with all involved departments. These studies have examined about 2,100 individual federal real properties and have identified 508 properties as having some potential for development and 147 of these as having significant potential.

6.107 At the time of this audit, final Area Screening reports on some major cities – for example, Vancouver and Calgary – had not been completed and published. But even for these cities, preliminary assessments were available.

6.108 The Area Screening Canada program is identifying properties which have potential for improved use. However, for only a small number of properties has the conduct of a study been enough to stimulate the resolution of outstanding concerns. For example, a 1978 study of the Quebec Urban Community identified a property of 2.9 hectares near the St-Malo Industrial Park belonging to National Defence. Based on the Area Screening report, the TBAC/FLM recommended that Public Works, on behalf of the Committee, enter into discussion with DND about the optimal use of the site. DND is now planning the construction of a building in 1985 that will take better advantage of the site.

6.109 The Area Screening reports are the only government-wide consolidation of information on the potential for improved use of government real property. It should be noted, however, that the economic implications of under-utilization are not estimated. A follow-up review on each completed study is to be carried out annually. Although most of the required follow-up reviews have been completed, many of the original TBAC/FLM conclusions and recommendations remain unchanged. Of the 508 cases where potential for more intensive use of a property was identified, in no more than 45 cases has there been sufficient progress to warrant a change to the original TBAC/FLM recommendation. In no more than 28 cases has the identified potential been realized.

The Significance of Cost Information on Economy and Efficiency in Managing Real Property

6.110 The manner in which costs are considered significantly affects managers' perceptions of what economy and efficiency mean in the context of real property. Managers generally are concerned only with the costs for which they are accountable and which they can control. In the government, many of the costs of real property are not visible to the manager responsible for its use or management. For example, some operating expenditures, such as grants in lieu of taxes, are charged to budgets quite removed from the persons accountable for either the use or management of the property.

6.111 Historically, proceeds from the sale of surplus real property have been credited to the Consolidated Revenue Fund. There has been little incentive for departments to transfer or dispose of real property which was not adequately used unless the annual expenditures charged to the department's own operating appropriation exceeded the value of the property to them. Since 1981, procedures of the Policy and Expenditure Management System (PEMS) have permitted Treasury Board to take into account the net proceeds from the sale of surplus real property when allocating resources to departments. Any increase in resources granted is to be used to acquire similar assets or to reduce departmental liabilities. This has the potential to improve economy and efficiency in the management of real property by focusing attention on the alternative use of assets.

The Significance of Opportunity Costs on the Efficient Use of Real Property

6.112 Although the value of nearly all real property has increased because of general price inflation, there has been a more significant increase in the value of some properties because of changes in the pattern of adjacent land use. These changes are reflected in what real property managers call the "highest and best use" to which the properties can be put. This is the potential for generating a larger net benefit from them, whether that benefit be defined in terms of profit or level of service. The benefit that a real property could generate, if put to its best alternative use, is defined as opportunity cost. If the property is already used at its highest and best use, there is no opportunity cost.

6.113 The concept of opportunity cost, which is well understood and used by the private sector, should also be used in the public sector. But the concept will need to be applied differently. In the private sector, decisions are usually made on almost purely economic grounds. Governments have complex objectives and may prefer to forego an opportunity to realize a greater financial net benefit so that it may achieve some wider social, economic or environmental objective. In such a case, the opportunity cost may be seen as the cost of a contribution to achieving the wider objective, rather than as simply a financial benefit foregone.

6.114 Opportunity costs are part of the costs of holding real property and, in certain circumstances, may even exceed all other costs.

6.115 A full analysis of the potential alternatives for an under-utilized property would require a detailed analysis of the costs and benefits of each alternative use of the property. This is beyond the scope of this audit. For purposes of illustration, in the cases described below, we have estimated the annual cost of holding the real property in its present use as the imputed interest on the current value of each property, plus the grants in lieu of taxes, less the revenue now being received. We have assumed a conservative interest rate of 10 per cent. The resulting values are approximate only and have been included to indicate the order of magnitude of the annual costs involved in holding these properties. They should not be interpreted to mean that the decision to hold property which is under-utilized was wrong. Indeed, many of the properties have appreciated significantly in value to the benefit of Canada. Nor should our presentation of these costs be interpreted as a suggestion that the properties be either developed or sold. Our presentation of these costs is intended to illustrate the economic significance of opportunity cost that is not usually identified or taken into account in the management of federal real property.

Cases

6.116 The following cases are all included in a completed or nearly completed Area Screening study.

6.117 **Block 56, Vancouver, B.C.** In 1972, Public Works purchased a block of property, Block 56, in downtown Vancouver for about $3.3 million. At the time, the intention was to build a new complex on the land to reduce long-term reliance on leased accommodation and, in the short term, to facilitate replacement or restoration of four old Crown-owned buildings on Block 15 that had deteriorated over the years and no longer met standards for health and safety. The new complex would have permitted relocation of the old building's occupants so that those buildings could be renovated or sold.

6.118 The preliminary steps to develop the Block 56 property involved reducing the scope because of a city zoning change in 1975, appointing an architect and preparing a preliminary design. In November 1978, however, the Minister of Public Works announced that the project was being halted because of the government's austerity measures. The architect was paid almost $800,000 for the preliminary design.

6.119 By 1983, Block 56 had appreciated, based on an appraisal conducted for DPW, to a value of about $17 million. Since 1978, the property has earned an annual rent of about

$12,000 as a parking lot for approximately 300 cars. Based on the 1983 appraisal, the annual cost of holding this block as a parking lot is around $1.7 million.

Block 56, a federal property in downtown Vancouver.

6.120 In late 1982, the Treasury Board authorized Public Works to lease a building at $358 per square metre, or about $6 million a year, to accommodate the occupants of the four old buildings in Block 15. This leasing action became necessary because the municipal Fire Warden and the Fire Commissioner of Canada strongly recommended, for safety reasons, that the four old buildings be vacated. Although the lease rate was attractive in market terms, DPW estimated that it was about 9 per cent higher than the forecast cost of occupancy for a new government-owned complex.

6.121 **DPW proposed letter processing plant site, Toronto.** In 1971, DPW paid $1.4 million for about 3.9 hectares of land on Dufferin Street in Toronto for a proposed letter processing plant. Between 1973 and 1983, the existing buildings and some of the land were let for about $65,000 a year. The property is currently let for about $89,000 a year. The Crown pays annual grants in lieu of taxes of approximately $12,000 on the land not under lease.

6.122 The Post Office informed DPW in 1979 that the property was not needed. The Department of Public Works is currently studying alternative uses for this property which was appraised at $5 million in 1981. Based on this appraisal and on an assumed interest rate of 10 per cent, the annual cost of the property exceeds $400,000.

6.123 An Area Screening report in 1980 noted that the property had significant potential for improved use, and a 1981 follow-up recommended that the site be reviewed. A review of alternative uses began in 1983, and a follow-up later that year recommended that the progress of the review be monitored.

6.124 **Dominion Public Building, 1 Front Street, Toronto.** This important heritage building, located in a prime downtown commercial area, was built in 1930. Operated by Public Works, it contains about 31,000 rentable square metres and is at present only about 50 per cent occupied. Public Works has stated that the building is structurally sound and has no major life safety hazards, but it sought Treasury Board approval on a number of occasions over the past decade to renovate this building. Because of this delay, former tenants of the building have had to be accommodated in other leased buildings at high rental costs. The annual rental value of the unused space, about 9,300 square metres, is about $850,000, based on a rental rate of $91 per square metre.

6.125 The 1980 Area Screening study recommended that ongoing improvements be monitored. A 1981 follow-up recommended a review of the property, and a 1983 follow-up recommended continued monitoring. In June 1984, the Treasury Board approved the renovation of the building.

Undisclosed Subsidies

6.126 The use of real property can result in a subsidy to a Crown corporation that, particularly when it arises from opportunity cost, may not be identified and may not be disclosed to Parliament.

6.127 **Canadian Forces Base Toronto, Downsview, Ontario.** Canadian Forces Base Toronto (Downsview) comprises about 349 hectares, including an airfield. Based on the sale of a portion of the property in 1979, the land at Downsview probably has a value of about $100 million.

6.128 A significant part of the base is the 170 hectares on which the runways have been built. Until 1982, both National Defence and deHavilland Aircraft of Canada Limited, a Crown-owned corporation, used the runways, but DND paid all costs of operation and maintenance. National Defence stopped using the runways in 1982, but has continued to maintain them for deHavilland on an operating cost recovery basis. Based on the 1979 sale, the land is worth about $50 million. Its annual cost is about $7 million a year, based on imputed interest and about $2 million a year in grants in lieu of taxes.

6.129 The operation of the airfield at CFB Toronto from the appropriations of DND generated a benefit to deHavilland for several years up to June 1982. In addition, its exclusive use by deHavilland since 1982, at an annual cost of about $7 million, is, in effect, a further subsidy to deHavilland. Parliament has not been informed about this subsidy.

Aerial photograph showing the extent of the runways on the Downsview lands.

6.130 The 1980 Area Screening study recommended that the property be monitored until plans for it were finalized. A 1981 review, however, recommended no further action, since the government had granted landing rights to deHavilland for 20 years.

Conclusions

6.131 The situation today is quite different from those found by the Glassco Commission and Senate Committee. The former found no inventory at all of the portfolio of real property while the latter found an inventory of sorts but no effective process for assessing whether real property was being used efficiently. Now, both policies and processes exist, but there is widespread failure to comply with the former or to use the latter.

6.132 **Real property is not managed in a way that recognizes its value.**

6.133 In the private sector, real property is held for some benefit, usually to meet a need for accommodation or as an investment to earn revenue. The government holds real property to achieve many objectives besides meeting the need for accommodation or earning revenue. Nevertheless, due regard for economy and efficiency implies taking into account the full costs of each property and its contributions to these several objectives. This is not done with federal real property. Furthermore, systems for monitoring cost are frequently absent or, if present, are functioning only to a limited extent notwithstanding a policy requirement for them.

6.134 Government policies on the management of real property by departments are generally adequate; however, there is frequent failure to comply with these policies.

6.135 The decision rules for managing a large and diverse portfolio of real property must reflect the organization's objectives. The government has, through its administrative and other policy statements, created a comprehensive set of such decision rules. These policies clearly require the exercise of due regard for economy and efficiency and generally provide managers with adequate direction.

6.136 We found, however, that managers frequently fail to give due regard to economy and efficiency in managing real property. We usually found this disregard of economy and efficiency associated with failure to comply with some aspect of government policy. Managers of real property recognize that they are unlikely to be held accountable either for non-compliance with government directives and guidelines or for the efficient use of real property, although they know they will certainly be held accountable for under or over-spending against their annual budgets and appropriations. The extent of this non-compliance means that the government has little control over the management of this large asset.

6.137 Managers' preoccupation with keeping within appropriations is illustrated by the omission of life cycle costs in decision-making on real property. Managers focus on the expenditures for which they are accountable rather than on the full cost to the taxpayer. This point was raised by Glassco in 1962, and this audit confirms that, at least for real property, it is still true today.

6.138 It is important to give due regard to economy and efficiency at all levels of decision-making, particularly in respect to space allocation, property utilization and development and acquisition choices. This means ensuring compliance with policy and having economy and efficiency in the management of real property figure importantly in the structure of accountability for managers. It also means having such accountability reinforced by reporting processes.

Recommendations

6.139 Based on the above conclusions, we make the following recommendations:

6.140 As required by the Treasury Board Control Framework, departments should implement appropriate control and monitoring processes to ensure compliance with administrative policies on the management of real property.

6.141 Opportunity costs should be considered in assessing the efficiency of actual or potential uses of real property.

6.142 Subsidies to Crown-owned corporations created through the use of real property held by departments should be disclosed.

MANAGEMENT OF TRAVEL

MANAGEMENT OF TRAVEL

Table of Contents

	Paragraph	Page
Audit Scope	7.1	7-1
Audit Criteria	7.5	7-1
Observations and Recommendations	7.6	7-2
Planning	7.9	7-4
Management Controls	7.17	7-5
Information	7.36	7-8
Central Travel Service	7.40	7-9

Exhibits

		Page
7.1	Travel Expenditures in Departments and Agencies	7-2
7.2	Average Travel Expenditure Per Employee	7-3
7.3	Central Travel Service - Statement of Operations	7-12

7

MANAGEMENT OF TRAVEL

Audit Scope

7.1 The purpose of this study was to determine whether travel funds were being managed with due regard for economy and efficiency in departments and agencies. We conducted a pilot study in the Marine Administration of the Department of Transport and examined travel management practices in the following five departments: Environment, External Affairs, Fisheries and Oceans, Indian Affairs and Northern Development, and National Health and Welfare.

7.2 We gathered information on these practices through interviews and analysis of questionnaires completed by departmental managers across the country, and we conducted audit tests on forms and records substantiating travel expenditures. We examined a representative sample of travel claims to identify the purpose of travel and assess the accuracy of claims and their general compliance with government-wide policies. We reviewed the Treasury Board Secretariat's and the Office of the Comptroller General's roles by examining the policies, directives and claim processing requirements affecting the management of travel. We assessed travel management practices against audit criteria developed for this purpose.

7.3 We examined the operations of the Central Travel Service of the Department of Supply and Services - Supply Administration to determine whether it demonstrated due regard for economy and efficiency.

7.4 Travel costs, for the purpose of this study, have been defined as the expenditures incurred for transportation, accommodation and meals by government employees and authorized persons, and other expenses incidental to travel. We excluded from the study the cost of travel on government-owned vehicles, aircraft and vessels and the expenses associated with relocation.

Audit Criteria

7.5 We assessed travel management functions against the following criteria.

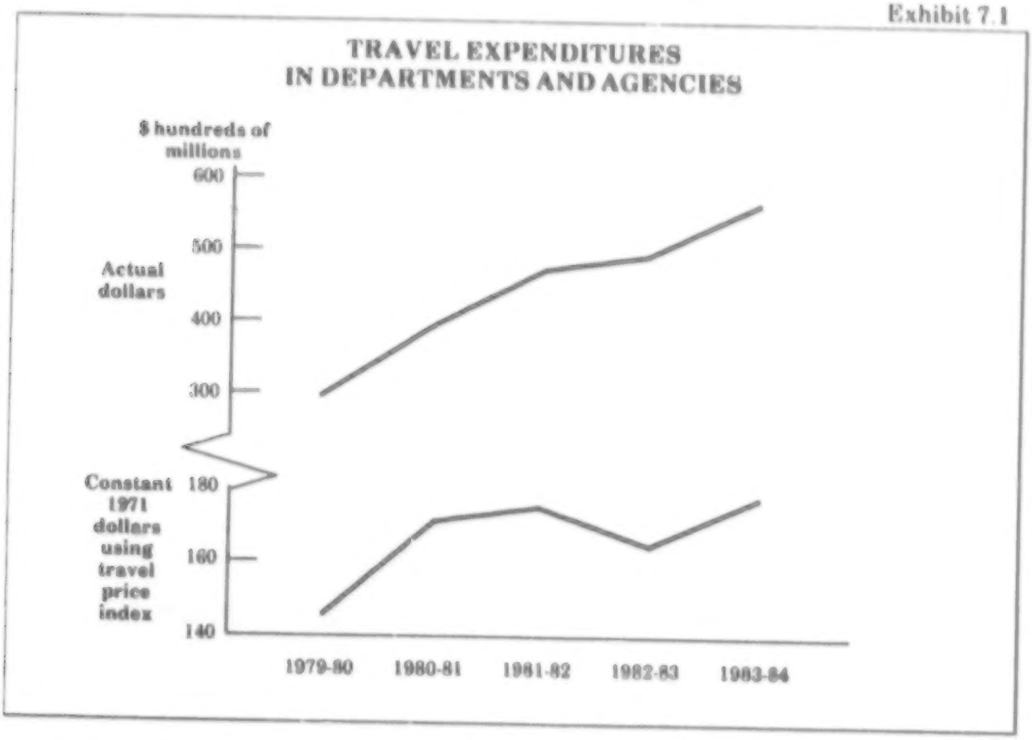
- **The need for travel should be projected and plans developed for meeting it in the most economical manner.**
  - the need for travel should be well defined and related to programs; and
  - alternative means of meeting travel needs should be assessed and the most economical and efficient method selected in travel plans.

- **Travel should be controlled.**
    - adequate policies, procedures and practices should be in place and enforced to ensure that travel expenses are authorized and reported, travel resources are not misused and travel needs are met by the most economical means; and
    - responsibility for authorizing and monitoring the use of travel resources should be clearly assigned.
- **Information on travel use and cost should be collected and made available to managers so they can estimate resource needs and monitor the use actually made of travel.**

Observations and Recommendations

7.6 As reflected in Exhibit 7.1, travel expenditures in departments and agencies have been increasing by an average of approximately 17 per cent a year over the past 5 years. Part of the increase in costs is due to rising fuel costs and general inflation. The growth in constant dollar terms is also depicted in Exhibit 7.1. In 1983-84, these expenditures reached $567 million. This represents an average of $1,700 in travel expenses

Exhibit 7.1

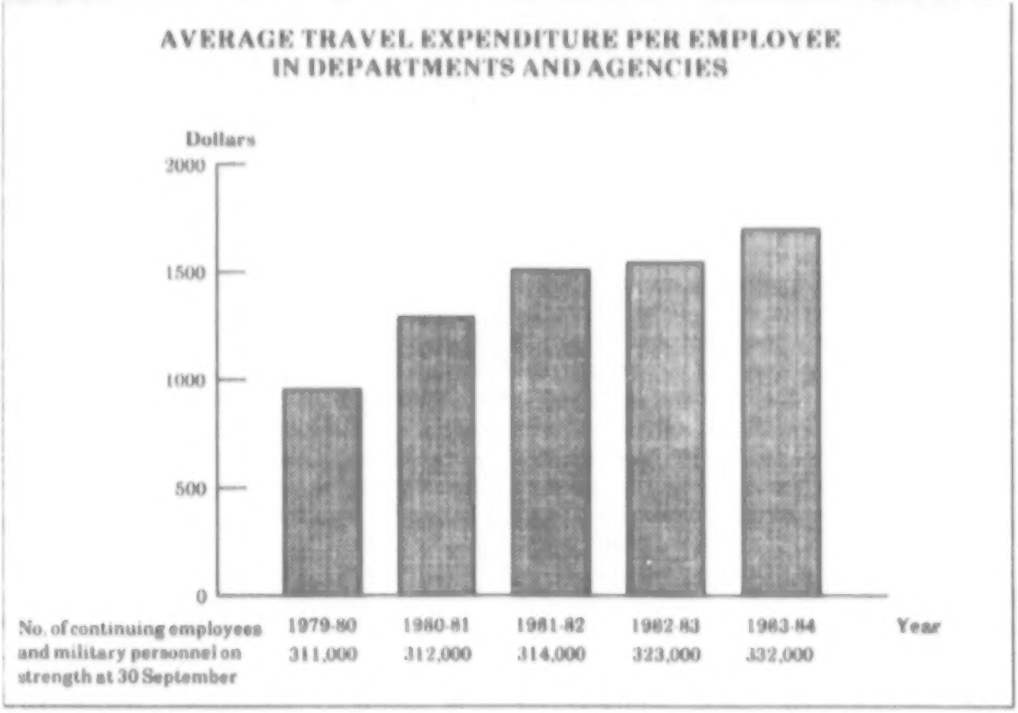


per employee on strength, as shown in Exhibit 7.2. This excludes the cost of government vehicles, financing of travel advances and related administrative tasks, and the cost of productive hours lost while travelling. It also excludes travel costs associated with contractual services or services paid for through grants and contributions. Included, however, are the costs associated with transportation of employees' dependants and non-government-employees in connection with various program activities. Approximately eight per cent of the stated expense for government travel is related to transportation of veterans, native people and other non-government-employees in connection with various program activities.

7.7 The level of travel resources needed depends on many factors and varies among departments and among programs within each department. The geographical dispersal of a program and the nature of the services that must be provided, ranging from inspection to international diplomacy, will obviously affect the need for travel. Our review of the travel claims selected revealed that travel resources were used as follows:

Operational travel	67 per cent
Departmental staff meetings	13 per cent
Conferences	11 per cent
Training	8 per cent
Employees' and dependents' entitlement travel	1 per cent

Exhibit 7.2



AVERAGE TRAVEL EXPENDITURE PER EMPLOYEE IN DEPARTMENTS AND AGENCIES

7.8 Our findings on the management of travel in the five departments are set out under the following headings: planning, management controls and information.

Planning

7.9 **Budgeting**. Departments and agencies are responsible for determining their requirements and related budgets. Planning and budgeting in departments and agencies require that travel estimates be projected based on actual operations with adjustments to allow for program changes and price increases. Once approved by Treasury Board and Parliament, operations and maintenance funds, which include provisions for travel, are distributed to program and operational managers. We generally found little evidence that, within this process, budgeting was based on a systematic assessment by departments of travel required for each major activity or project. While we observed cases of good planning within some departmental organizations, responsibility centre managers were generally not required to provide information to justify the travel component of their budgets on the basis of their operational and administration requirements.

7.10 **Restraint measures.** In 1982, the Treasury Board introduced government-wide measures to reduce travel and minimize travel costs through restricting foreign travel, attendance at conferences and business travel. This involved holding ministers responsible for co-ordination and approval of such travel and for achieving a reduction of 15 per cent in discretionary travel, based on 1981-82 actual expenditure levels. The travel restraint measures were expected to reduce departments' and agencies' annual travel funds by at least $15 million in 1983-84 and each subsequent year.

7.11 Although overall travel expenditures increased by $23 million in 1982-83 and by $68 million in 1983-84, there is a lack of data available on the extent and definition of discretionary travel and misunderstanding by departments about what it is. Thus it was not possible to measure the success of the restraint program.

7.12 **Travel arrangements**. One of the most important aspects of travel management is preliminary planning, including identification of who should travel, and why and when travel resources should be spent. Planning is fundamental to getting the best value for travel resources and making the most efficient use of travel time. Consideration of opportunities for reducing travel time and costs is important if these are to be achieved. Most government travellers believe that when they book transportation and reservations through Central Travel Service they are getting best value. This is not always the case, particularly in respect to foreign travel arrangements and where savings are available through advance bookings and excursion rates.

7.13 There was little evidence that due consideration was given to available reduced rates. We realize that, in some instances, these special airline rates can involve travel conditions which interfere with operational requirements. Nevertheless, the reduced rates should be used as much as possible when circumstances are favourable. This also applies to the use of alternatives such as teleconferencing or other modes of transportation.

7.14 We found that managers were not sufficiently involved in providing guidance for their staffs to improve the economic use of travel resources.

7.15 **Managers should play a more active part in providing guidance for their staffs for determining travel arrangements to ensure due regard for economy and efficiency.**

7.16 **Managers should determine travel needs on the basis of specific operational and administrative requirements.**

Management Controls

7.17 **Policies and guidelines.** Treasury Board's travel policy provides government-wide guidance and direction on the procedures to be followed in respect to authorization of travel, travel allowances and submission and review of travel claims. The entities studied have also adopted specific departmental policies and directives. We found that these policies were generally satisfactory. They prescribe a consistent set of rules for determining allowable travel expenditures. However, we observed that, in certain cases, they tended to generate significant amounts of paperwork and processing costs. This issue is discussed in more detail in the section on administrative costs.

7.18 **Compliance with travel policy**. We selected a random sample of 526 travel claims from the five departments, to assess the accuracy of the claims and compliance with the government's travel policy. In our examination of the claims, we found that 17 per cent contained monetary errors. On the basis of the audit result, we estimate that there is $1.2 million or 1.5 per cent overpayment in the $81.8 million travel expenses reported in the five departments selected. The errors we found appeared to be due mostly to misinterpretation of entitlements and miscalculation of allowances.

7.19 For the travel claims examined, with the exception of pre-authorization procedures, there was evidence of satisfactory compliance with the travel policy and with the authorizations required by sections 26 and 27 of the Financial Administration Act. Pre-authorization procedures, however, were not being complied with, possibly due to the numerous requirements. In the travel claims examined, 46 per cent had one or more deviations from the travel policy in regard to key pre-authorization procedures which we identified for the purpose of our sample. We understand that the Office of the Comptroller General and the Treasury Board Secretariat are currently reviewing the potential for simplification of pre-authorization requirements.

7.20 **The Office of the Comptroller General and the Treasury Board Secretariat should pursue their initiative to investigate the potential for simplifying the travel pre-authorization process and follow up accordingly on the matter of non-compliance with the existing procedures.**

7.21 **Airline travel**. Airline fares represent a significant portion of the expenditure on travel in the federal government. Central Travel Service's records show that a total of $97 million of airline tickets was purchased through its reservation services in 1983-84. Travellers also buy tickets direct from airlines, but there are no statistics for this. Because of the amounts involved and the difficulty of tracing airline tickets, stringent controls have to be maintained. We found areas, as described below, where control weaknesses exist that need to be addressed by departments and agencies.

7.22 **Travel authority numbers.** To make a reservation through the Central Travel Service, a travel authority number must be obtained. This gives the traveller authority to purchase an airline ticket. In principle, control should be maintained over the issue of this number to ensure full accountability for all tickets purchased on its authority. Each travel authority number should be restricted to the use of one traveller for one trip. We found that the registers used by departments to control travel authority numbers were poorly designed and that, in some cases, ticket purchases and refunds due for returned tickets and unused coupons were not accounted for. Transportation costs were not always recorded in travel authority number registers as required. On numerous occasions, the same travel authority number was used by more than one person or for more than one trip without any notation to account for the exception. The systems within the departments examined generally had no provisions for recording such explanations. Thus, because other weaknesses exist, unauthorized and questionable purchases of airlines tickets could go through the system without being noticed. We were informed that such cases were found and are currently being investigated by the departments involved.

7.23 **Airline tickets**. Even though airline fares are paid by departments, it is important that ticket stubs be submitted with travel claims to enable managers to confirm the cost of the trip and the route taken. Any unused portions of tickets can then be processed and returned to the airline companies for refund.

7.24 We found several cases where airline ticket stubs were not submitted with travel claims, making it possible that, because other deficiencies existed as well, unauthorized trips could be taken and paid for by the government. We also found cases where refunds were not requested for unused tickets. At the time of our examination, one department's travel audit organization had 200 unused tickets or portions of tickets in its possession that had not been returned for refund because travellers had unduly delayed reporting them, or follow-up procedures had not been carried out properly by the organization. Some of the tickets were for travel in March and April 1983. An employee in the same department returned a partially unused ticket in 1984 that had been issued in 1981 for $2,440.

7.25 Within some departments, we found that verification of CTS billings was not consistently carried out to ensure that the trips had been actually taken and approved before paying CTS.

7.26 Departments and agencies should consistently reconcile CTS billings with costs recorded in the travel authority number registers.

7.27 **Administrative cost of travel.** The Treasury Board's travel policy includes numerous types of travel entitlements and is inter-related with other directives. The policy requires numerous audit checks that must be carried out in the verification of travel claims. This has resulted in a significant number of adjustments to claims, greatly complicated the review of travel claims, and led to correspondingly high administrative costs.

7.28 The pre-audit of travel claims (that is, before they are paid) which is required under the policy is the responsibility of travel audit sections within departments' and agencies' financial and administrative organizations. We found that these sections were conducting detailed pre-audits on all travel claims regardless of the total amounts involved. There were, in some cases, backlogs of unprocessed claims. As an example, an organization in one department had a backlog of 2,378 unprocessed claims at time of our audit, representing a delay of approximately 10 weeks in the settlement of these claims. In another department, we noted that travel claims for standing advances, which for economy ought to be reported monthly, were being submitted in some cases two or three times a month because of the long delays in receiving reimbursements for travel expenses.

7.29 Few of the travel audit sections in the departments we audited kept any statistical information on the number, dollar amount or types of errors found as a result of the pre-audit of travel claims, or on where most errors were occurring in the department. This kind of information could be used to inform responsibility centre managers where travel procedures need to be strengthened and corrective action taken.

7.30 We found a number of organizations within departments where complete verification of audit claims was being carried out locally before the claims were pre-audited by the travel audit sections.

7.31 Changes such as the following could be made to reduce the administrative costs of processing travel claims.

- The travel policy provisions could be simplified.
- Travel voucher processing could, in our view, be speeded up and simplified through the application of appropriate sampling techniques. (However, if errors discovered exceeded a predetermined standard, the examination could revert to a 100 per cent review.)
- The administrative cost for handling claims could be reduced by adopting flat rates to cover the cost of such things as home phone-calls and hotel accommodation, as is now done for meals and incidental expenses.

7.32 We understand that the Office of the Comptroller General and the Treasury Board Secretariat are currently addressing the area of productivity improvement in the processing of travel claims.

7.33 Departments should take steps to avoid unnecessary duplication in the pre-audit of travel claims.

7.34 Departments' and agencies' travel audit sections should compile information on the number, cost and types of errors found as a result of pre-audits of claims and use this information to inform managers where travel management practices should be improved.

7.35 The Office of the Comptroller General and the Treasury Board Secretariat should pursue their review of the travel policy provisions and the applicability of statistical sampling techniques with a view to identifying the potential for reducing the administrative cost of processing travel claims.

Information

7.36 There was a general lack of meaningful information on travel costs across government. Some departments have a large number of travel line object classifications. This results in compilation of extensive travel data, some of which is not used, and increased coding complexity and processing cost. For example, as many as 30 travel cost categories have been established in some of the departments examined. There was no consistent approach to the way travel data were identified by departments and agencies so that they could be analysed to provide for a proper assessment of program needs.

7.37 A large percentage of departmental managers lacked information on where and how travel costs are incurred, even though travel expenditures were regularly and consistently recorded against line object codes. Few managers used the coded data for planning and monitoring purposes because the information provided was not related to program activities. We did observe one sector in one of the departments which collected information on travel and related costs for a broader review of travel and consideration of alternatives in subsequent travel plans. This information was being gathered at minimal cost and, at the time of our study, was being made available to managers for planning and monitoring. The system was also being used to control employees' travel from the time it was authorized until trips were completed and accounted for.

7.38 In setting up travel categories, departments ought to strive for more useful information for internal and global needs, which could be used to study trends and developments.

7.39 **Departments and Agencies should establish better travel information for improved operational planning and control.**

Central Travel Service

7.40 We examined the financial functions and operations of Central Travel Service, the agency within the Department of Supply and Services responsible for providing transportation and reservation services for government travellers. The agency negotiates rates for accommodation and car rentals and issues the Government Hotel Directory and Car Rental Directory. It also manages the central payment and billing system for the collection of Air Canada, CP Air and Via Rail accounts from government departments and agencies who use their services. The government travel policy requires that reservations for transportation and accommodation be made through Central Travel Service, with the exception of the Department of National Defence. The Department of External Affairs does not normally use CTS services when arranging trips at foreign posts. CTS estimates that it made reservations for some 240,000 air trips and some 144,000 hotel reservations in 1983-84.

7.41 **Arrangements with the two major airlines**. Central Travel Service has an arrangement with Air Canada and CP Air whereby the airlines provide reservation services for accommodation and car rentals as well as for air travel. The airlines do not collect their

Ticket purchase
Billets

CP Air and Air Canada provide special information and reservation services for air travel, accommodation and car rentals to government employees.

usual commissions from hotels and car rental agencies. They also pay a one per cent collection fee to the government on all transportation purchased by government travellers. The fee paid for 1983-84 was $958,897.

7.42 In handling government travel business, the two major airlines realize savings because they do not have to pay the normal commissions to travel agents. The total of such savings by Air Canada and CP Air is estimated at $4.4 million for 1983-84. This is offset to some degree by the airlines' costs of providing the services.

7.43 Since its inception in 1968, Central Travel Service has negotiated reduced government rates for hotels. In 1978, this negotiation was extended to car rentals. For the year 1983-84, Central Travel Service reported that it had produced savings to government amounting to $2 million by negotiating special government hotel and car rental rates which were made possible in part through the airlines' waiving of commissions. Such commissions would normally be collected directly by the airlines for making hotel and car rental reservations.

7.44 **Central payment and billing system**. CTS pays airline and railway invoices for government travel and then recovers the amounts from departments and agencies. Through this system, CTS is able to provide some information about the extent of government travel. However, the system is administratively costly and, in our opinion, is not essential to the provision of a central travel service. Maintenance of this payment and billing system by the Supply Administration results in duplication with the accounts settlement process in departments.

7.45 CTS is unable to collect its accounts promptly from departments and agencies. Past due departmental accounts of 31 days and over fluctuated during 1983-84 from a monthly low of $7.0 million to a high of $17.9 million. For the past two years, there has been at least $2.5 million of accounts 120 days old and over. As of September 1984, a net amount of $390,000 was outstanding in respect to invoices more than two years old. This situation is partly due to poor collection efforts, errors in postings and billings, and unidentified adjustments. The departments were also at fault for not clearing their accounts promptly.

7.46 Concerted collection efforts during the last few months of 1983-84 reduced the $2.5 million in overdue accounts to $1.8 million by 31 March 1984. However, many accounts may never be properly cleared. Because the accounts are so old, departments may not be able to identify the transactions or the persons responsible. In 1983-84, CTS obtained a $7,000 refund from one airline for a travel account that had gone undetected for two years. In another case an employee was required to reimburse $1,300 for personal travel that had been charged to the government in 1981.

7.47 Some of the problems observed by the Supply Audit Branch in a review conducted in 1982 were of the following nature:

- backlog of entry data;
- rapid growth of uncleared transaction data in the suspense file;
- incorrect matching of invoice and cash receipts data;
- duplicate input of invoices; and
- little or no collection activity because staff did not know what to collect or who to collect it from.

Efforts by a project team and the Comptroller's organization were increased to clear up the system's problems. Even though there appears to be an ongoing improvement in the system, the problems associated with it still existed at the time of our study.

7.48 Central Travel Service, as one of many services financed by the Supply Revolving Fund, is required to demonstrate its ability to control its assets and financial operations. This includes a requirement to manage its accounts receivables so that its annual statement of operations discloses the use made of the government funds advanced to pay the airlines on a weekly basis.

7.49 In practice, the Supply Administration has never identified, for the Treasury Board's annual rate review, the agency's annual cost of operations, the bases used for allocating costs, or the effect the contracts with the airlines have on the costs and benefits of central travel service. The Administration advised us that they intend to do so in the future.

7.50 Entities financed by revolving funds are required to cost their operations the way private enterprises do, even to the extent of including interest as a cost. The agency reported that, for 1982-83, after recording $775,000 for interest, it had an operating loss of $867,000 (see Exhibit 7.3). For 1983-84, the Supply Administration estimated the agency's loss at $742,000. The interest amount was computed for the accounts receivable only on the first 30 days. Had full interest been calculated on the agency's cash draw-downs until the accounts were paid by departments and agencies, we estimate that the additional interest charges would have been $4.0 million for 1982-83 and $3.4 million for 1983-84. Had CTS been charged that amount, it would have recovered an equal amount from the departments, and thus CTS's overall financial results would not have been affected. Nevertheless, we believe such a charge would have made the departments more conscious of the impact of neglecting to pay promptly their CTS accounts.

7.51 According to the Supply Administration, the reason for not calculating interest on cash draw-downs was that the settling of these paid accounts with departments and agencies is internal to government and, therefore, interest should not be charged because it has no impact on Consolidated Revenue Fund (CRF) operations. The major question of concern relating to the agency's obligations to the CRF was whether the Fund paid the airlines promptly for transportation tickets bought by government travellers. In this regard, there seems little doubt that the airlines are receiving faster settlements of their accounts than would be the case if they were dealing directly with departments and are also avoiding a significant amount of administrative cost.

Exhibit 7.3

CENTRAL TRAVEL SERVICE
STATEMENT OF OPERATIONS
FOR THE YEAR ENDED 31 MARCH 1984
(in thousands of dollars)

	1984	1983
Revenue		
Transportation tickets purchased by departments and agencies	$ 97,031	$ 85,053
Less payments by CTS for transportation tickets	96,073	84,216
1% collection fee	958	837
Expenditure		
Salaries and Employee Benefits	209	196
Publications	65	82
Professional and Special Services	41	20
Accommodation	25	28
Miscellaneous Expenses	35	42
Interest	730 *	775
Total Direct Expenditure	1,105	1,143
Divisional Overhead	38	30
Corporate Systems and Overhead	349 *	332
Branch Overhead	41	40
Directorate Overhead	167 *	159
Total Overhead Expenditure	595	561
Net Expenditure for the Year	$ 742	$ 867

Source: departmental records.
* Department's estimate for comparison only

7.52 The large number of overdue accounts and the discrepancies in the statements of accounts provided to departments have contributed to the cost of maintaining the Central Travel Service. The obligation to collect airline accounts from departments, rather than having the departments pay the two airlines directly, places an additional administrative burden on the Supply Administration and on departments and agencies for billing, accounting, collection, settlement and follow-up of accounts.

7.53 Central Travel Service should assess the costs and benefits of collecting airline and rail accounts from departments through the Supply Revolving Fund and compare them with the costs and benefits of having departments pay the airlines directly. The terms of the arrangements with the airlines should then be renegotiated if appropriate.

Supply Administration response: The Supply Administration has commissioned an outside consulting firm to conduct a study of the Central Travel Service Payment and Billing System in order to determine an alternative cost effective method to the present centralized payment and billing arrangements for airline ticket purchases.

7.54 **Cost reduction and savings**. Our evaluation of the agency's activities in terms of its service role and objectives indicates that it is providing a valuable and useful service by issuing the Government Hotel Directory and Car Rental Directory. The agency reported cost savings of $2,119,000 for 1983-84 from hotel and car rental negotiations. This estimate does not take into consideration savings on reservations made directly by travellers. These cost savings were estimated on the basis of assumptions about the duration of stay at hotels and discounts realized. The accuracy of the amount stated as savings are somewhat questionable because of the lack of data on actual hotel and car rental costs for government travellers. If the agency is to show it is achieving significant economies, accurate measurement of these savings is important. Management is aware of this and is currently studying the situation to obtain more accurate performance indicators.

7.55 The agency also achieved savings through its central audit of airline transportation routings and rates. These resulted from refunds from the airlines related to incorrect tariff rates, inaccurate tax calculations, and arithmetical errors. The refunds as a result of the audit, which was conducted by one member of CTS' staff, amounted to $130,000 for 1983-84.

7.56 **Level and quality of service**. In the course of interviewing responsibility centre managers in the departments and reviewing complaints formally made to CTS, we encountered some concern that the CTS quality of service was less than adequate. These criticisms suggested that the government traveller is not always offered the lowest air fare and that hotel reservations made by CTS cannot always be relied on. We observed cases of regular use of travel agents rather than CTS by some responsibility centres for these reasons.

7.57 We understand that the Supply Administration is currently reviewing this situation through the program evaluation process.

7.58 **Control over ticket purchases**. Controls over the use of travel authority numbers were not exercised properly in some of the departments examined. As a result, tickets may be acquired for unauthorized or personal flights. With the existing weakness, noted earlier, in departmental reconciliation of CTS accounts and late payments to CTS, we are concerned that such tickets could be paid for at government expense. As an example, disclaimer of billings by one department in 1979 led to the identification of a fraud case involving the purchase of 31 airline tickets for personal use at government expense. This five-year-old account was settled in May 1984 after reimbursement was demanded from one of the major airlines.

7.59 CTS should issue guidance to departments and agencies on the proper use of travel authority numbers to ensure that numbers are used to account for each individual ticket purchased.

> *Supply Administration response: This procedure is clearly defined in TB Administrative Policy Manual Chapter 370; nevertheless, CTS will be conducting informational and educational sessions with all customers on the many aspects of the service and will specifically address the issue of the proper use of Travel Authority Numbers.*

7.60 **Unredeemed airline tickets**. As with any airline service, some tickets or coupons will not be redeemed because of loss, theft, accounting errors or partially completed trips. No estimate could be placed on the value of such tickets unredeemed by government, and the airlines have no system at present for reporting them. We observed several cases where unused coupons had not been properly processed and refunds obtained.

7.61 Central Travel Service should negotiate with Air Canada and CP Air to ensure that all unredeemed tickets and coupons, after a reasonable period of time, are reported for appropriate follow-up by departments and agencies.

> *Supply Administration response: Ongoing discussions with the airlines on the possibility of a data-link transfer of information will include this subject. However, it remains the responsibility of individual Deputy Heads to ensure that the requirements of section 27 of the Financial Administration Act are satisfied.*

MANAGEMENT OF JOB CLASSIFICATION

MANAGEMENT OF JOB CLASSIFICATION

Table of Contents

	Paragraph	Page
Introduction	8.1	8–1
Audit Scope and Approach	8.20	8–5
Audit Criteria	8.31	8–7
Observations	8.33	8–7
A System Under Pressure	8.34	8–8
A System Under-Managed	8.41	8–11
A System Lacking Accountability	8.62	8–16
Conclusions and Recommendations	8.71	8–18
Controls Over Quality and Cost Implications of Decisions	8.80	8–20
Review of Work Performed	8.84	8–21
Greater Accountability for Management	8.89	8–22

Exhibits

		Page
8.1	Changes in Population Distribution By Level: Program Administration (PM) Occupational Group: 1966-83	8–10
8.2	Changes in Population Distribution By Level: Clerical and Regulatory (CR) Occupational Group: 1978-83	8–10
8.3	Changes in Population Distribution By Level: Computer Systems (CS) Occupational Group: 1978-83	8–12
8.4	Changes in Population Distribution By Level: Personnel Administration (PE) Occupational Group: 1978-83	8–12

8

MANAGEMENT OF JOB CLASSIFICATION

Introduction

8.1 Job classification refers to the processes used to determine the relative worth of jobs in the federal public service. The process involves writing a description of the work performed or to be performed, allocating the job to a specific occupational family and, based on the evaluation of such factors as knowledge and skills required to do the work, assigning the job to an occupational group and level within the occupational family.

8.2 Job classification systems and practices in public and private sector organizations vary considerably depending on such factors as the size of the organization, the complexity and distribution of the workforce and the nature and extent of involvement of employee bargaining agents. They range from systems much simpler than that used in the federal public service to those of equal or greater complexity.

8.3 Job classification can have a major impact on the cost of operating an organization. Because all systems for evaluating jobs involve a degree of judgement in the evaluation of an individual job, they are subject to some degree of error which can result in misclassification – the over or under-classification of the job. Over-classification can result in overpayment for the work performed relative to other public servants. Under-classification can result in underpayment and the possible loss of a trained and valued employee or in difficulties attracting competent employees. Misclassification can also have a significant impact on staff morale if employees do not perceive themselves to be classified, and therefore paid, equitably.

8.4 Since 1976, the Treasury Board Secretariat, the central agency responsible for managing the federal public service job classification system, has conducted two government-wide audits to assess the extent of misclassification. Both audits reported a significant rate of misclassification and, in particular, significant over-classification. The most recent audit, conducted in 1983, indicated that one in five public service positions was incorrectly classified, resulting in overpayment for the work performed. For the sample of positions audited, Treasury Board Secretariat calculated the cost of over-classification at 2.7 per cent of straight-time payroll. Treasury Board Secretariat also concluded that the rate of misclassification had worsened since its first service-wide audit.

8.5 In our 1983 annual Report, we noted deficiencies in the management of job classification in our comprehensive audits of departments and in our service-wide study on constraints to management. The deficiencies included major delays in addressing a misclassification problem that affected a large number of positions in one department. In our study of constraints to productive management in the public service, we found that the public service managers interviewed were generally of the view that public service classification practices were difficult and time consuming.

The public service job classification system covers 71 diverse occupational groups.

8.6 Given the significance of known problems in job classification, this year we examined the management of the system at the Treasury Board Secretariat level and in departments. As well, we reviewed relevant management practices in a variety of other public, private and quasi-public sector organizations.

8.7 **Federal public service job classification.** The current system for classifying jobs has been in place since the late 1960s. The principles governing the system were developed by the Preparatory Committee on Collective Bargaining which concluded, among other things, that the system should permit different approaches to wage and salary administration for different types of employees; provide a logical framework for determining bargaining units and negotiating rates of pay; and permit extensive delegation to departments of the authority to classify positions.

8.8 The current system comprises the following six broad occupational families or categories:

- Management;
- Scientific and Professional;
- Technical;
- Administrative and Foreign Service;
- Administrative Support; and
- Operational.

8.9 These categories are further sub-divided into 71 occupational groups representing a wide variety of occupational skills and work. The system includes about 292,000 positions and applies to approximately 222,000 federal public servants. The excess of positions over employees includes those surplus to requirements as well as a number to provide flexibility to meet changing organizational arrangements and to accommodate hiring temporary employees. The system provides for a variety of approaches to rating jobs depending on the nature of work performed within an occupational group.

8.10 In the federal public service, the terms "job" and "position" are used somewhat interchangeably. "Job" refers to one position or to several essentially similar positions that can be described in one written job description. In this chapter, we have used the term "job" wherever possible and refer to "position" only where the context requires it for accuracy.

8.11 Job classification is closely intertwined with collective bargaining since, generally, bargaining agents represent employees along occupational group lines as defined by the job classification system. The classification system itself is excluded from collective bargaining under the provisions of the Financial Administration Act and the Public Service Staff Relations Act.

8.12 Section 7(1)(c) of the Financial Administration Act assigns Treasury Board the authority to provide for the classification of positions. Responsibility for managing the classification system is vested in the Personnel Policy Branch of the Treasury Board Secretariat.

8.13 In line with the principle of extensive delegation of classification authority, Treasury Board has delegated to deputy heads of departments and heads of agencies the authority to classify most positions. In 1982, more than 98 per cent of all departmental positions were covered by delegated classification authority. Treasury Board Secretariat has retained the authority to classify only the more senior level jobs in the Management Category as well as certain levels in selected occupational groups in which significant classification problems have been identified.

8.14 The principal roles fulfilled by Treasury Board and its Secretariat are developing and maintaining classification standards, promulgating policies and guidelines governing job classification, training and accrediting personnel specialists in job classification, auditing and evaluating the system and providing mechanisms for resolving disputes over classification decisions.

8.15 The policies governing job classification in the federal public service provide for the use of committees to evaluate jobs and require that persons other than departmental deputy heads and associate deputy heads authorizing job classification decisions be trained and accredited by Treasury Board Secretariat. They also provide administrative arrangements for resolving disagreements on classification decisions. In addition, Treasury Board policy requires that the accuracy of existing job descriptions be monitored and that the correctness of classification decisions be periodically audited by departments.

8.16 An important element of Treasury Board policy provides that the salaries of public servants whose jobs are found to be over-classified be maintained, or protected at current levels, even though the level of the position is reduced, until such time as the employee leaves the position through reassignment or other avenues. This means that the overpayment costs associated with misclassification can continue for a protracted period – it also emphasizes the importance to achieving economy in human resource costs of making a correct classification decision in the first place, rather than relying on corrective action.

8.17 In 1979, after its first government-wide audit of job classification, Treasury Board withdrew from all departments the authority to classify positions at certain levels in a few occupational groups with an inordinately high level of misclassification. With the exception of departmental deputy heads and associate deputy heads, Treasury Board also limited the exercise of classification authority to persons accredited in job classification by Treasury Board Secretariat. These modifications had the effect of withdrawing classification authority from line managers where this was the practice and placing it with personnel specialists. In the current system, line managers are responsible for preparing job descriptions, and personnel specialists are responsible for making and authorizing the decision regarding category, group and level.

8.18 In 1982, Treasury Board entered into an arrangement with the Public Service Commission whereby the Commission conducts audits of specified aspects of the classification process in departments on behalf of Treasury Board. Currently, this arrangement covers compliance with selected aspects of Treasury Board policy, including reviewing and updating job descriptions and monitoring the classification process.

8.19 In 1984, after its second government-wide audit, Treasury Board took steps to tighten controls over the authorization and funding of upward classification changes and to implement an information system for monitoring the cost of classification changes. The Board also reinforced the requirement that departments conduct periodic audits of job classification decisions by requiring departments to provide copies of their annual monitoring and audit plans and related reports, including corrective action undertaken. The Board also announced its intention to carry out a more extensive audit of the quality of classification decisions in 1984-85.

Audit Scope and Approach

8.20 The objective of our audit was to assess the extent to which due regard for value for money – in particular, economy – was being demonstrated in the management of federal public service job classification.

8.21 Our examination included a review of classification activities in several departments, as well as the policy and technical framework for job classification established by Treasury Board and its Secretariat. We also reviewed job classification practices in 13 selected private, public and quasi-public sector organizations.

8.22 **Treasury Board Secretariat.** At Treasury Board Secretariat, we examined the policies, guidelines, directives and relevant management controls governing the classification system. We also reviewed key aspects of the supporting systems, including development and maintenance of classification standards and training of personnel specialists in classifying jobs.

8.23 **Departments.** We examined systems for classifying jobs in the following five departments:

- Agriculture;
- Consumer and Corporate Affairs;

- Environment;
- National Defence (civilian staff only); and
- Secretary of State.

8.24 In addition, we drew on our comprehensive audit and pilot project findings in the area of job classification in three other departments: Energy, Mines and Resources; National Health and Welfare; and Statistics Canada.

8.25 Our examination in departments included an assessment of management controls over job classification. In most departments, we reviewed a sample of recent classification decisions made in the National Capital area and one or two regions. We also examined the actions taken in each department to correct classification anomalies identified in recent Treasury Board Secretariat and departmental audits. Finally, we interviewed personnel specialists with classification authority and a sample of operational managers who had recent experience with the classification system.

8.26 **Other sector practices.** To develop a current appreciation of management practices in job classification, we surveyed job classification practices in 13 organizations selected from the private, quasi-public and other public sectors. The organizations reviewed represented a variety of economic sectors as well as municipal and provincial governments, the United Nations and the U.S. government.

8.27 Our survey of other sector practices focused on management practices rather than the type of job classification plan being used. For example, we gathered information concerning the exercise of classification authority, the processes for making classification decisions and views on acceptable rates of misclassification.

8.28 **Exclusions.** Our audit did not include the classification plan recently implemented for the Management Category because it is relatively new. Nor did we examine the classification of positions subject to Governor in Council appointment because they are relatively small in number and not typical of the major portion of the federal job classification system. For the same reasons, our audit did not include the classification of those jobs where the level is largely determined by the skills, knowledge and achievements of the incumbent or by other factors as in the Research Scientist and Foreign Service occupational groups. Because of the specialized nature of their classification systems, our audit did not include the uniformed members of the RCMP or of the Canadian Armed Forces.

8.29 In view of the two service-wide audits of individual positions carried out by Treasury Board Secretariat since 1976, our audit program did not include testing the accuracy of the classification of individual positions. We did, however, review the methodology and working papers from the most recent Treasury Board Secretariat audit to determine the extent to which we could rely on that work as a service-wide indicator of the health of the job classification system.

8.30 Finally, because of the pervasive and complex linkages of job classification to other human resource management systems and the collective bargaining process, our audit did not include an in-depth examination of the fundamental structural elements of the current job classification system, such as the number and structure of occupational groups and categories.

Audit Criteria

8.31 Our examination of job classification was based on the following audit criteria which were developed in consultation with central agency and department representatives.

- **Job classification decisions should reflect correct application of valid classification standards.**
  - classification decisions should be based on an accurate description of the work performed or to be performed;
  - classification decisions should be made by persons knowledgeable of the work performed or to be performed and of the application of classification standards;
  - classification standards should be reviewed periodically and, if necessary, revised to ensure they accurately reflect the nature of work performed.
- **The classification and related cost implications of proposed allocations of work should be considered before such allocations are finalized.**
- **Classification decisions should be monitored to assess their impact on related jobs; they should be audited periodically to ensure their accuracy; anomalies should be corrected promptly.**

8.32 Where appropriate, we also applied the audit criteria concerning the development, implementation and review of policy set out in our 1981 annual Report chapter on payroll costs management.

Observations

8.33 In a well balanced job classification system, the inevitable upward pressures for higher classifications and pay are restrained by effective management controls. Our examination revealed that the public service job classification system is under considerable upward pressure from a variety of sources. It also revealed that countervailing forces, such as good management practices, effective accountability relationships and related reporting mechanisms, relevant policies and good working tools, are not strong enough to offset these pressures.

A System Under Pressure

8.34 Depending on underlying circumstances, classification activities can take a variety of forms ranging from routine changes, such as altering the identification number of a position, to more substantial actions, such as verifying the currency of duties described, to complex actions involving the classification of many new or changed jobs as might occur in a major reorganization. Also, classification changes can be sought to reward employees, facilitate recruitment, resolve perceived pay inequities, or to solve other personnel problems more appropriately dealt with through other human resource management systems. Managers and personnel specialists indicated these factors created significant upward pressure on the system.

8.35 We estimate that more than one out of every two public service positions was subject to some form of classification activity involving minor or more substantive action in 1983. In one department, the number of classification actions was nearly double its allotted person-years and 150 per cent of the number of established positions. Not all actions involved a change in the rating of the position; in four of the departments audited where estimates were available, an average of just over 80 per cent of actions were routine or administrative. Nevertheless, we view this level of activity as high because it is roughly twice that reported by other sector organizations.

8.36 We also observed a number of practices in other sector organizations, not generally present in the federal public service, that serve to hold down the volume of classification requests. These practices included the requirement for executive approval of all organization changes prior to classification action; the extensive use of committees of managers to evaluate jobs; on-site verification by personnel specialists of the job description with the immediate supervisor before classification action; and higher management approval of proposed job descriptions before classification action takes place. We found restraining measures of this type in place in only one of five departments we audited; that department also had a significantly lower rate of classification activity than all others audited.

8.37 Another potential indicator of pressure on the system is the rate of promotion without competition through upward reclassification of jobs. In the four years from 1980 through 1983, there has been an average of about 4,700 of these promotions each year. As a percentage of all promotions, those resulting from upward reclassification increased from 16.9 per cent in 1980 to 22.6 per cent in 1983 – an increase of about 33 per cent. From 1981 through 1983, the number of promotions of all types fell by about one-third, probably as a result of curbs on the growth of government and reduced turnover related to difficult economic circumstances. In the same period, the number of promotions resulting from upward reclassification did not fall proportionately, but by only 12 per cent, indicating upward movement in classification levels at a time when the overall size of the public service was being restrained. The table below displays the actual number of promotions and reclassifications and the change in rate of promotions resulting from upward reclassification from 1980 through 1983.

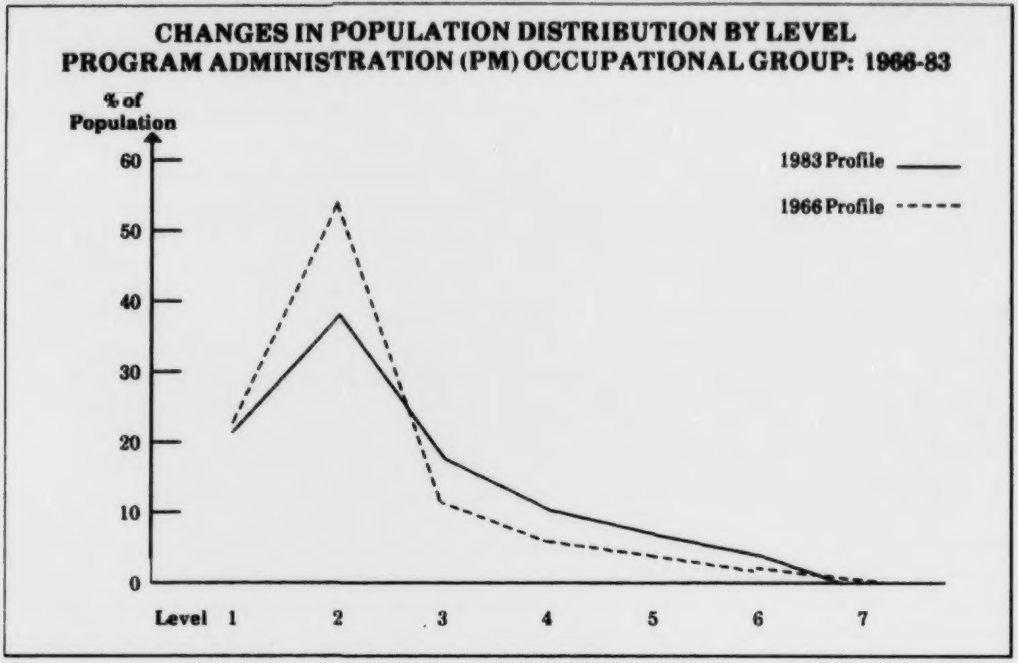
Promotions Without Competition Resulting From Upward Job Reclassification (as a percentage of all promotions) 1980-83

Year	Total Promotions	Reclassifications	Reclassifications as % of Total Promotions
1980	24,270	4,106	16.9%
1981	30,062	5,132	17.1%
1982	26,360	5,225	19.8%
1983	19,949	4,512	22.6%

8.38 The shift of the employee population in an occupational group from lower to higher levels is yet another potential indicator of pressure on a job classification system. Such shifts may be a legitimate reflection of increasing complexity and diversity of work performed in the organization. Dramatic changes in EDP technology in recent years and a similar evolution in office technology illustrate this phenomenon. However, they may also be a reflection of problems in applying the system or of using the system to serve unintended purposes, such as to increase employee compensation, even though an increase may not be justified by application of the classification standard. We analysed population shifts in a number of occupational groups and found a marked decrease in the proportion of employees at lower levels and a significant increase in the proportion of employees at the higher, better paying levels. These shifts were detected in particular occupational groups in most individual departments audited as well as in several occupational groups across the public service.

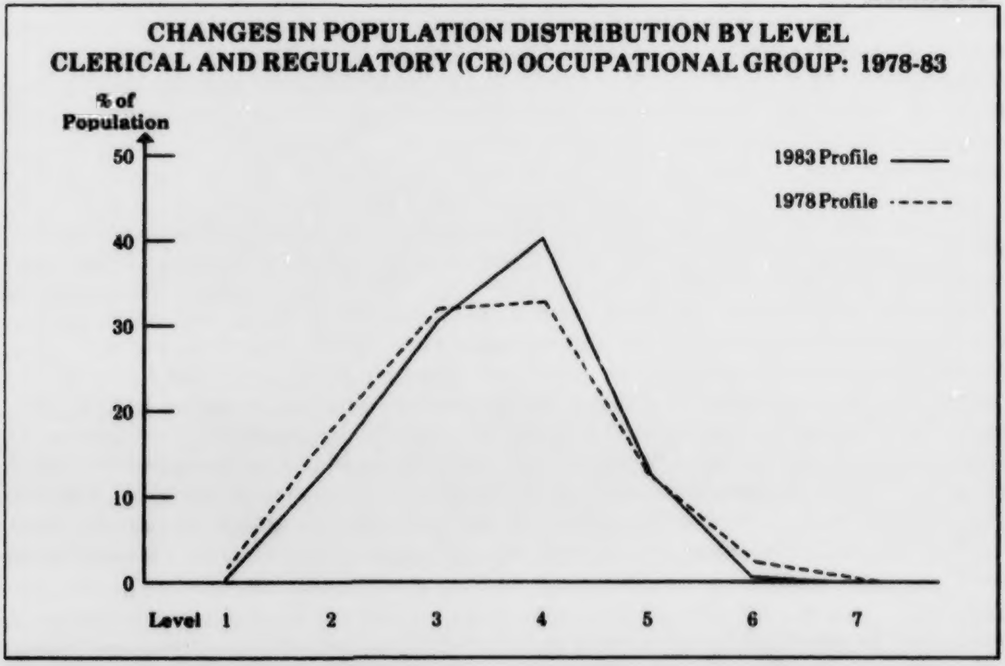
8.39 Exhibits 8.1 and 8.2 show the shift from lower to higher levels across the public service in two occupational groups – Program Administration (PM) and Clerical and Regulatory (CR), over a number of years. For the PM Group in 1983, the number of employees at the higher levels, PM-3 to PM-6, had increased by 62 per cent while those at lower levels had decreased by 20 per cent compared to the distribution of the PM population in 1966. This represents an estimated annual straight-time salary cost in 1983 of about $14 million. Similarly for the CR Group, but over the considerably shorter period 1978 to 1983, the number of employees at the higher levels, CR-4 to CR7, increased by 13 per cent while those at lower levels decreased by 12 per cent. The estimated annual straight-time salary cost of this shift was about $13 million in 1983. We found the upward shifts in these two occupational groups to be significant because, together, the two groups account for about 75,000 public servants – about one-third of the total number of employees covered by the system.

Exhibit 8.1



CHANGES IN POPULATION DISTRIBUTION BY LEVEL
PROGRAM ADMINISTRATION (PM) OCCUPATIONAL GROUP: 1966-83

Exhibit 8.2



CHANGES IN POPULATION DISTRIBUTION BY LEVEL
CLERICAL AND REGULATORY (CR) OCCUPATIONAL GROUP: 1978-83

8.40 Some occupational groups were relatively free of upward shifts in employee population. Exhibit 8.3 shows that the distribution of employees in the Computer Systems (CS) Group remained stable from 1978 to 1983. Exhibit 8.4 shows there has been a slight downward shift in the distribution of employees in the Personnel Administration (PE) Group. We noted with interest that authority to classify positions in these occupational groups has been retained by Treasury Board Secretariat for levels 3 and above in the CS Group since the current system was established and, since 1979, for levels 4 and above in the PE Group.

A System Under-Managed

8.41 Treasury Board and its Secretariat have taken a number of steps in recent years to improve control over the job classification system. They include increased audit activity, modifications to the delegation of classification authority and withdrawal of delegated authority from departments on a service-wide basis for certain problem groups and levels. Despite these initiatives, our examination indicated significant weaknesses in the direction and technical support provided by the central agency and in management controls at both the central agency and department level.

8.42 **Central direction and technical support.** As the responsible central agency, Treasury Board Secretariat has promulgated an extensive policy and procedural framework governing job classification in the public service. Our examination revealed non-compliance by departments with several of the more important policies including the requirement to review and update job descriptions on a systematic basis and the requirement to audit the quality or correctness of classification decisions. Although the fact of non-compliance has been known to Treasury Board Secretariat for several years, there has been no concerted effort to ensure a higher level of compliance by departments. Apart from service-wide action affecting all departments, we were unable to find a single instance where sanctions were applied, such as withdrawing or restricting delegated classification authority in individual departments where non-compliance was a known problem.

8.43 Treasury Board Secretariat is responsible for developing and maintaining classification standards. The standards are the technical cornerstone of the job classification system and are designed to facilitate consistency in job classification decisions. There is a standard for each occupational group in which the rating plan – factors and criteria used to determine the relative worth of a job – for the group is outlined. Each standard also contains benchmark job descriptions that illustrate work performed at different levels within the group. It is through applying the rating plan and making detailed reference to the benchmark jobs that the assignment of a job to a level is decided and justified.

8.44 To be fully effective, classification standards must be an accurate reflection of the work performed by members of the occupational group. Treasury Board Secretariat originally attempted to ensure currency of the classification standards through a seven-year cyclical review program. It was unable to maintain this schedule. In practice, Treasury Board Secretariat responds to emerging needs to update or revise standards in accordance with the perceived urgency of the problems being experienced.

Exhibit 8.3

CHANGES IN POPULATION DISTRIBUTION BY LEVEL
COMPUTER SYSTEMS (CS) OCCUPATIONAL GROUP: 1978-83

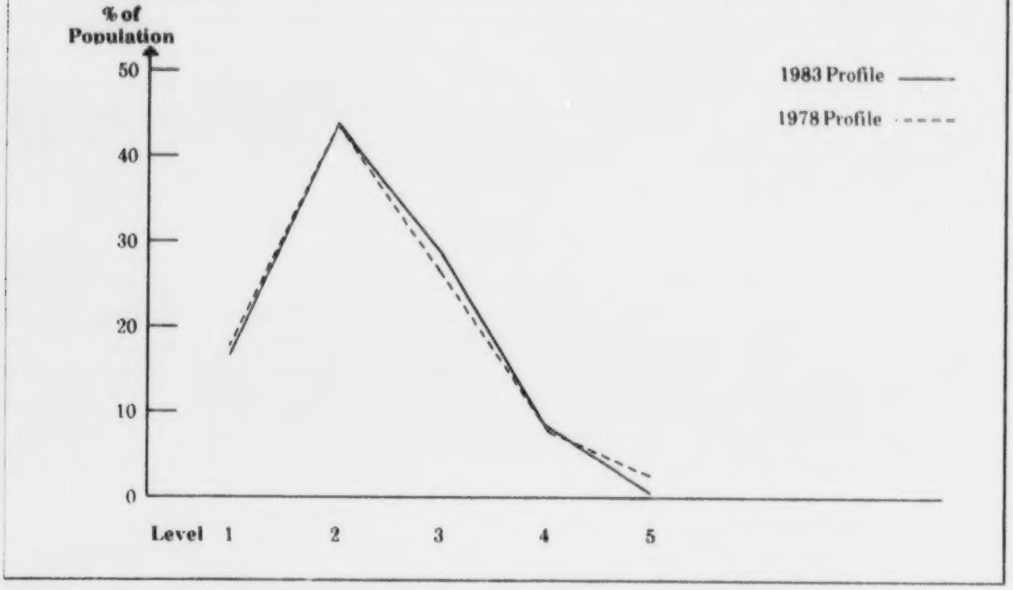
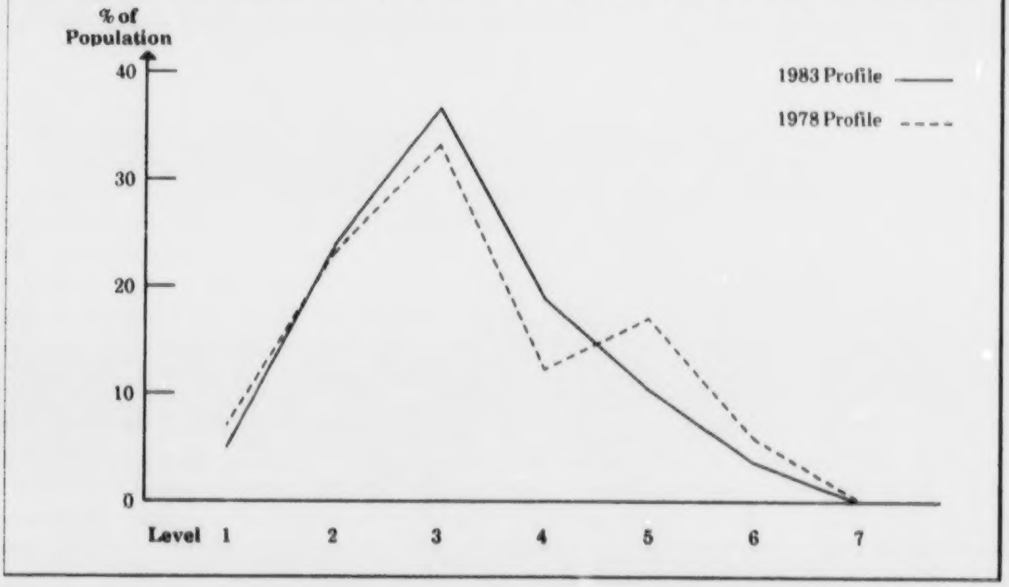


Exhibit 8.4

CHANGES IN POPULATION DISTRIBUTION BY LEVEL
PERSONNEL ADMINISTRATION (PE) OCCUPATIONAL GROUP: 1978-83



8.45 We examined a selection of classification standards that had undergone or were in the process of major revision. We found the process of revision was complex, involving extensive consultation and requiring a long time to complete. We noted that, prior to 1978, the average time required to complete a major revision to a standard was 4.2 years. The three major standards revisions we reviewed and which were in process after 1978 required more than six years to complete. In addition, we found that minor revisions to update benchmark job descriptions lagged significantly.

8.46 Personnel specialists and operational managers interviewed during our audit were of the view that the most important improvement that could be made to the system would be to update the classification standards – in particular, benchmark job descriptions. In our survey of other sector practices, we were informed that benchmark jobs are reviewed every two to three years; none was reported older than five years. In contrast, our review of Treasury Board Secretariat classification standards indicated that many benchmark job descriptions had not been revised in more than 10 years.

8.47 **Monitoring, audit and evaluation.** As a condition of delegated classification authority, departments and agencies are required to have in place effective measures to control the exercise of that authority. Required measures include monitoring and auditing such aspects of the classification system as the currency of job descriptions and the quality of classification decisions. Also, Treasury Board Secretariat as the manager of the classification system is responsible for reviewing the exercise of delegated classification authority and evaluating the effectiveness of the classification system as a whole.

8.48 **Monitoring.** Our examination of the monitoring of ongoing classification activity by Treasury Board Secretariat and departments indicated that there is not adequate control over the quality of classification decisions or the cost implications of organization change and its related classification decisions. Neither is there strong control over the costs of operating the classification system, particularly those services provided by personnel specialists in departments.

8.49 Treasury Board Secretariat monitoring comprises a quarterly review of changes in classification levels resulting from classification decisions in departments in the previous year. The information system, Classification Early Warning System (CLEW), is based on data derived from the public service pay system. When an apparently significant shift is perceived by Treasury Board Secretariat, the department responsible is asked to provide information to Treasury Board Secretariat about the shift in levels. The Secretariat has had some success with this system in detecting and correcting unwarranted shifts; however, the system is deficient because it does not monitor the nature or extent of classification activity directly. Because the CLEW system does not contain data on departmental positions, information from the system cannot be readily reconciled with departmental classification records. Few departments had confidence in or used CLEW data to monitor their own operations. Further, CLEW is not used by Treasury Board Secretariat as a systematic means to monitor longer-term shifts over a four or five-year period that may go undetected in a quarterly review of changes over a one-year period.

8.50 One other Treasury Board Secretariat system, the Official Languages Information System (OLIS), gathers information that could be used to monitor classification activity directly. OLIS, however, cannot be used for classification monitoring purposes because it is overloaded with data on surplus positions. This restricts its use as an effective monitoring tool. Treasury Board Secretariat's efforts to rectify this situation have not been successful.

8.51 The Secretariat's plans to replace CLEW with an improved monitoring system, Classification Action Reporting System (CARS), were aborted in 1983 because the costs of the improved system were not viewed as warranted. As a result, Treasury Board, the central agency responsible for job classification, does not have direct information on the nature or the extent of the activity for which most of its authority has been delegated to departmental deputy heads.

8.52 Treasury Board policy requires departments to establish performance standards and measures for their personnel management activities and operations and to monitor those activities. In departments, we found that monitoring practices for job classification vary widely in terms of scope and effectiveness. Few departments audited had standards and measures in place to monitor the quality and quantity of service provided by classification specialists. This is a matter of some concern; we noted there are about 500 of these specialists service-wide. Most departments did not have good information on the number and nature of classification activities. For example, most could only estimate the overall volume of the various types of job classification activity.

8.53 Because of the lack of sound performance-related information in most departments audited, we could only estimate the quality and quantity of service provided by classification specialists. Our estimates identified several important differences among departments in key areas of classification operations. They included the following:

- differences in the average time required to process a classification decision – the range was from just over 4 weeks to over 11 weeks;
- differences in the average effort required to produce a classification decision – based on estimated hours of personnel specialist and line manager time in one comparison of two departments, the difference was from a low of 20 hours to a high of 61 hours per decision; and
- differences in annual output of classification decisions by each personnel specialist, ranging from a low of 27 decisions to a high of about 68.

8.54 **Audit.** As discussed previously, in line with its responsibility for auditing the performance of departmental classification activities, the Treasury Board Secretariat has conducted two service-wide audits of the quality, or correctness, of classification decisions since 1976. The rates of misclassification, that is, the percentage of positions found to be classified incorrectly relative to the classification standard, were 17.8 per cent reported in 1978, and 23.8 per cent reported in 1983. In both audits, about 80 per cent of the classification errors resulted in overpaying the incumbent of the position for the work actually performed. On the basis of these two service-wide audits, Treasury Board Secretariat also concluded that the system had deteriorated significantly over the period from 1978 to 1983.

8.55 We reviewed the audit techniques and statistical methods used in Treasury Board Secretariat's most recent audit of the quality of classification decisions and concluded that the audit presents a reasonable picture of the rate of misclassification in the public service at the time it was done. We also concluded that the Secretariat's estimate of the net annual cost of misclassification (the total cost of over-classified positions less the cost reductions of the relatively few under-classified positions) at $125 million, or 2.4 per cent of straight-time payroll, is reasonable. Using Treasury Board Secretariat's raw data, we calculated the confidence limits for this estimate. We determined with 95 per cent confidence that the actual straight-time salary cost could range from $90 million to $157 million a year in 1983 dollars. We noted that this estimate did not include the salary-related costs of employer paid benefits such as contributions to pension and insurance plans and other salary-related entitlements.

8.56 Following its 1978 audit, Treasury Board Secretariat informed departments of their misclassified positions and requested that each be reviewed and that appropriate corrective action be taken. The Secretariat did not, however, vigorously follow-up on its requests for corrective action, and most departments were very slow to address individual problem positions. In a similar example, in one department, corrective action on a misclassified position identified in a 1980 audit, which represented about 1,200 similar positions, had been delayed for over three years. In four departments audited, the average time required to correct misclassified positions identified in the 1978 Treasury Board Secretariat audit ranged from 6 months to 2.5 years. By way of contrast, when senior officers of Treasury Board Secretariat brought pressure to bear on departments early in 1984 to correct misclassified positions identified in the 1983 service-wide audit, corrective action on most problem positions was swift.

8.57 Because of concern over the extent of misclassification reported in 1978, Treasury Board Secretariat undertook individual audits of the job classification process in all departments and agencies. These audits focused on compliance with Treasury Board Secretariat policies and directives and, in some departments, included an assessment of the quality or correctness of classification decisions. These audits revealed significant weaknesses in departmental controls over job classification and led to recommendations to each department for corrective action. We followed up on these recommendations in the departments we audited and found that most departments had responded in the form of a corrective action plan; however, most corrective action to date has been of a housekeeping nature such as clarifying statements of roles and responsibilities. The more substantive recommendations in terms of management improvement, such as the development of performance indicators and improved management information on job classification, have not yet been implemented in most departments.

8.58 Our review of departmental audit practices for job classification revealed that most departments have established or are setting up some form of audit capability. However, these audit activities seldom included a review of the quality or correctness of classification decisions where duties actually performed are compared to those described in the job description and to the classification standard. Most department classification audit programs simply focused on aspects such as completeness of documentation and compliance with procedures.

8.59 In some departments, the auditing of the quality of decisions is carried out by personnel specialists who are directly or indirectly linked to making the decision in the first place. This compromises the independence and objectivity of the audit. Compounding this problem, Treasury Board Secretariat issued policy guidelines in 1982 reinforcing that assessments of the quality of decisions should be conducted by personnel units rather than by independent internal audit units.

8.60 **Evaluation.** In addition to the two service-wide audits of positions and the audit of individual departmental classification processes conducted by Treasury Board Secretariat, there have been six major studies addressing or touching on job classification since 1974. Most were commissioned by Treasury Board or its Secretariat. These studies identified problems or made recommendations in such areas as improving the management of standards (in five studies), improving controls and accountability (in four studies), and simplifying the structure of job classification (in three studies). Despite the persistence of this advice, Treasury Board and its Secretariat have not acted on it in a systematic and concerted manner.

8.61 The Treasury Board Secretariat conducted an evaluation of one policy on job classification in 1983-84 – the training and accreditation of classification specialists. However, we are concerned that there were no plans to evaluate, until at least 1986, a number of elements of classification policy where our audit identified weaknesses in content or clarity as well as non-compliance by departments. We include such policy areas as the use of classification committees to evaluate positions, periodic on-site audit of the quality (correctness) of classification decisions, use of occupational group profiles to assess organization change, review of the costs and benefits of organization change and related classification decisions, the requirement for departments to consult with the Secretariat before making significant classification decisions that could affect other departments, and jobbing practices (the use of one job to justify the classification level of one or more similar jobs).

A System Lacking Accountability

8.62 In view of our observations concerning pressures within the classification system and our concerns with respect to the adequacy of the countervailing forces, we examined in some detail the issue of accountability. This included accountability for managing the system at both the Treasury Board Secretariat and departmental levels and accountability for the quality of classification decisions made under delegated authority.

8.63 We compared accountability for the classification system to accountability for several other important public service personnel activities and found marked differences in reporting requirements and practices. The Public Service Commission, for example, is required to report annually to Parliament on its activities with respect to staffing the public service. The Treasury Board is required to report annually to the government on its official languages program. With regard to affirmative action programs for women, handicapped people and native people, the Treasury Board Secretariat is required to report to the Treasury Board or Cabinet on the results of its activities. By contrast, we found no requirement for the Treasury Board or its Secretariat to render any periodic accounting on its stewardship of the public service classification program. The Financial Administration Act, which provides the Board with its authority for classification, states that the Treasury Board "...may provide for the classification of positions". It requires no periodic reporting of activities or results.

8.64 The Civil Service Commission, the agency responsible for classification before the enactment of the current legislation in 1967, was required to report annually to Parliament on its activities. We reviewed the annual reports published prior to 1967 and noted that job classification was included in some detail and provided a basis for the Commission to account for its responsibilities.

8.65 In 1965, the Preparatory Committee on Collective Bargaining set out a number of objectives which governed the design of the current job classification system. We reviewed the Treasury Board Secretariat's current operational objectives for job classification and found that they were not goal-oriented, specific or measurable. In the absence of clearly stated objectives, performance criteria and related measures, it is difficult to see how Treasury Board Secretariat could be held accountable in a meaningful way for managing the classification system. We were particularly concerned to find that Treasury Board Secretariat does not have a specific performance standard with regard to the rate of misclassification. Most other sector organizations we reviewed reported specific standards for rate of misclassification, ranging from an idealistic zero per cent to a high of five per cent.

8.66 With regard to departmental management of the system, policies governing its operation state that deputy heads are responsible and accountable to the Treasury Board for complying with the conditions of delegation of classification authority and for the integrity of the system within their departments. There is no requirement, apart from recent and as yet untested initiatives by Treasury Board and the recent requirement for departments to submit audit and monitoring plans, for a systematic flow of information from departments to the Secretariat or to Treasury Board that would support such an accountability relationship. This is in sharp contrast to the staffing system whereby departments must inform the Public Service Commission of every appointment made under delegated authority to staff. Indeed, there is no requirement for departments to inform Treasury Board Secretariat, even in summary form, of the exercise of delegated authority to classify jobs.

8.67 In each department audited, we interviewed personnel specialists and operational managers with recent experience in classifying jobs. Personnel specialists are responsible for the quality (correctness) of classification decisions; operational managers are responsible for program and related costs. Neither saw themselves accountable for the cost implications of organization changes and related classification decisions. We noted a similar division of responsibilities between personnel specialists and operating managers in private sector organizations; however, we also observed that the onus on the manager for profitability created a powerful incentive to be aware of and to minimize salary costs. During our review of practices in other sectors, we noted that one provincial government had implemented a system for reporting periodically to individual deputy heads and to the deputy ministers of the responsible central agency on the potential salary cost implications arising from job classification decisions in individual ministries. Provincial officials reported that the system had produced good results in motivating senior managers to be aware of and to control increases in salary costs resulting from organization and classification change.

8.68 The Treasury Board policy concerning classification delegation requires departments to consult with Treasury Board Secretariat before implementing classification decisions that may involve potentially significant increases in salary expenditures. There is no other reference in classification policies to the salary costs of classification decisions other than the statement that the deputy head is responsible for the "integrity" of the system. It can only be inferred that salary costs are included. We view this as a serious omission in policy direction.

8.69 In May 1984, the President of Treasury Board announced, as a direct response to the findings of the 1983 Treasury Board Secretariat audit, a series of initiatives, one of which specifically addressed the issue of accountability. This initiative involves establishing an index number for each department or agency derived from average salary costs and approved person-years. Changes in job classification levels will be reflected in a department's index number and will be monitored on a monthly or quarterly basis by Treasury Board Secretariat. The concept is being developed in a small group of departments and may lead to delegation of classification authority in departments to senior managers who will be held accountable for the exercise of that authority through monitoring of their salary cost index.

8.70 This initiative, if it proves viable, should lead to improved accountability for job classification decisions within departments and between departments and the Treasury Board. It will not, however, address directly most of the deficiencies we have noted in management practices, nor will it ensure sound administration of the classification system.

Conclusions and Recommendations

8.71 We have set out our findings with respect to what we believe to be significant upward pressures on the public service job classification system and with respect to identified deficiencies in the management of the system at both the Treasury Board Secretariat and departmental levels. We have also outlined significant weaknesses in accountability for public service job classification.

8.72 There is a serious imbalance between upward pressures on salary costs arising from the classification of jobs and countervailing restraining forces. This imbalance is shown by:

- the increase in the rate of upward reclassification of positions leading to promotion of the incumbent without competition;
- the shift in the distribution of employees from lower levels of several occupational groups to higher-paid levels; and
- a significant rate of error in the classification of jobs that has resulted in close to one employee in every five being overpaid, relative to other public servants, for the work actually performed.

8.73 This deficiency is serious because its effects tend to degrade the credibility of the job classification system in the minds of those directly affected by it – employees, managers and personnel specialists. To be effective, a job classification system must be seen to be fair, objective and equitable; where it is not seen in this way, staff morale suffers because of the perceived inequities, and misuse of the system increases to address them. Diseconomy results.

8.74 We believe that the fundamental cause of the weaknesses identified in this audit is that departmental managers, who initiate and influence job classification decisions, feel no sense of ownership or responsibility for the classification system. Because departmental managers view the classification system as a central agency "personnel" system, and because increases in salary costs arising from upward job reclassification have been funded automatically by Treasury Board, managers have not been motivated to control the effects on salary costs of organization change and related classification decisions. In our view, effective corrective action requires that managers be motivated to be aware of and to control these costs.

8.75 A public service employee is entitled to be paid for duties performed and responsibilities fulfilled. It is our view that public service managers have a responsibility, as trustees of public funds, to ensure that full value is received for salary dollars spent. This means that public service managers must be motivated to consider the benefits to be derived from proposed changes in organizational arrangements and related classification decisions in terms of their associated cost implications. In practical terms, public service managers must be aware of, and control, the effects on their organization of incremental classification change which, over time, can dramatically affect the costs of program delivery.

8.76 We are of the view that sweeping, fundamental changes in the structure for public service job classification are neither necessary nor desirable, for the following reasons:

- The close integration of the job classification structure with that for collective bargaining means any changes in the former would have significant effects on well established relationships for the latter.

- Any move toward a major recentralization of authority for classifying jobs at the central agency level would be inconsistent with the well established management philosophy in the Canadian public service that responsibility and authority are delegated to departmental deputy heads to the maximum extent feasible.

- The costs of major structural change to the current system and the consequent disruption in the workplace would likely be great.

- There are significant opportunities for improvement within the present structure.

8.77 We do not advocate more procedural controls or further constraints over the job classification system. What is needed, in our view, is improved effectiveness in the existing control framework together with incentives for managers, personnel specialists and the responsible central agency to ensure that the classification system is managed with due regard for value for money.

8.78 Recent initiatives announced by the President of Treasury Board to gather information on classification changes in departments, to undertake another service-wide audit of the quality of classification decisions, and to implement measures to ensure that departments absorb salary cost increases arising from classification changes from existing budgets will likely address some of the problems revealed in our audit. However, we are not confident that these measures go far enough or that they will address the more fundamental management issues.

8.79 To address these problems, we believe that concerted action is required to ensure the following:

- more effective controls over the quality of classification decisions and the cost implications of organizational change and related classification decisions;

- more effective review of work actually performed relative both to work described and to classification standards; and

- more effective accountability at all levels for the management of the system.

Controls Over Quality and Cost Implications of Decisions

8.80 In our opinion, the quality control framework within which classification decisions are made must be reviewed and significantly improved. It is far more cost-effective and conducive to good employee relations to ensure that a decision is correct when it is made than to undertake corrective action after an error is made. In the quality control framework, we include the adequacy and currency of classification standards and policy direction with regard to such key elements of job classification as using committees to evaluate jobs and requiring departments to consult Treasury Board Secretariat before making significant decisions that could affect other departments. These elements of policy should be reviewed in terms of their content, clarity and effectiveness and either reinforced or, where they are inappropriate to effective control of classification decisions, revised or cancelled.

8.81 Treasury Board Secretariat and departments should ensure that classification decisions are subjected to rigorous and effective quality control measures before they are implemented.

8.82 Ways must be found to ensure that both the short and longer-term cost effects of proposed new organizational arrangements and the related classification decisions, particularly upward reclassification, are known and subject to review. Such reviews should include assessment at the departmental level of the costs and benefits of the proposed decisions relative to alternative ways of organizing and allocating work. Visibility and control over the costs of classification change could be greatly facilitated if the documents requesting and authorizing a classification decision included reference to the projected costs of the classification change.

8.83 The Treasury Board Secretariat and departments should develop measures to ensure that consideration is given to the cost implications of organization changes and related classification decisions.

Review of Work Performed

8.84 In the current system, on-site review of the relationship between work actually performed and the written job description, and the relationship of both to the classification standard (audit of the quality of decisions), is conducted by the Treasury Board Secretariat in individual department audits or service-wide. Departmental activities in this area, although a requirement of Treasury Board policy, are not extensive, nor are they integrated or co-ordinated with the audit activities of Treasury Board Secretariat.

8.85 To assess the health and integrity of the system, the Treasury Board Secretariat needs to develop a systematic, integrated and co-ordinated approach to the periodic audit of job classification decisions. Such an approach would require that departments comply with Treasury Board policy concerning on-site review of classification decisions and that the Secretariat co-ordinate the total audit effort to provide for meaningful year-to-year comparisons of performance at the level of the individual departments as well as service-wide. This approach would also help to avoid wasteful duplication of audit effort. It would provide a rational basis for determining whether the rate of misclassification is stable, improving or deteriorating and for determining the nature of appropriate corrective action to ensure that value for money is obtained in the classification of jobs. In conjunction with this co-ordinated audit effort, the Treasury Board Secretariat needs to develop specific and measurable targets for reducing the rate of misclassification.

8.86 Treasury Board Secretariat should develop and implement a systematic, integrated and co-ordinated approach to periodic audit of the classification system and use the results to assess the performance of the system and the need for any corrective action.

8.87 Where classification problems, including inadequate departmental performance, are identified, Treasury Board Secretariat should be prepared to act directly and decisively to ensure that the problems and the factors that led to them are addressed by departments. Where appropriate and necessary, Treasury Board should be prepared to apply sanctions, including restricting or removing delegated classification authority from individual departments.

8.88 Treasury Board and its Secretariat should ensure that classification problems are corrected effectively and promptly through the application of sanctions where appropriate.

Greater Accountability for Management

8.89 Considerable effort has been expended over the past few years in assessing the effectiveness of the current classification system. The Treasury Board and its Secretariat have moved in some areas to strengthen management controls. We believe that these activities should continue and be reinforced. We are also of the view, however, that accountability for the integrity of the system is the most fundamental issue that must be addressed. Further, we believe that accountability at all levels would be greatly strengthened if means were devised to provide greater visibility of job classification and its cost implications.

8.90 As we noted earlier, the importance given to other human resource programs, such as staffing and official languages, has resulted in annual reporting by the responsible organization to Parliament or to government. In our view, the importance of the job classification system in terms of its linkage to organization change and its implications for payroll expenditures warrants similar visibility.

8.91 We believe that an annual report to Parliament by the Treasury Board and its Secretariat would do much to enhance visibility, increase scrutiny and ultimately improve accountability for the public service job classification system. A report, based on information provided by deputy heads, could set out the system's key operating characteristics, such as the nature and extent of classification activity by department and across the public service. It could also address the related cost implications of this activity, the overall performance of the system in terms of the rate of misclassification, and steps taken to address problem areas.

8.92 Treasury Board should report annually to Parliament on the activities and performance of the public service job classification system.

CANADIAN INTERNATIONAL DEVELOPMENT AGENCY

CANADIAN INTERNATIONAL DEVELOPMENT AGENCY

Table of Contents

	Paragraph	Page
Overview	9.1	9–1
Audit Scope	9.6	9–1

Observations and Recommendations

	Paragraph	Page
Managing the Agency	9.7	9–2
Program Structure	9.8	9–2
Strategic and Operational Planning	9.10	9–3
Comprehensive Agency Management Plan (CAMP)	9.19	9–4
Food Aid Program	9.31	9–6
Planning	9.34	9–8
Objectives and Accountability	9.36	9–9
Needs Identification	9.41	9–10
Monitoring	9.45	9–11
Transportation	9.49	9–13
Evaluation	9.51	9–14
Bilateral Program Management	9.55	9–16
Aid and Trade	9.59	9–16
Project Management	9.61	9–18
Identification of Need	9.75	9–24
Planning and Approval	9.77	9–24
Implementing Projects	9.86	9–29
Evaluation	9.105	9–35
Multilateral Programs Branch	9.109	9–36
Special Programs	9.117	9–38
Planning and Approval	9.123	9–39
Monitoring and Evaluation	9.125	9–39

	Paragraph	Page
Support Functions		
Payroll Costs Management	9.129	9–40
Financial Management	9.143	9–42
Internal Audit	9.147	9–43
Corporate Memory and Program Evaluation	9.152	9–44
Case Studies		
Skim Milk Powder - Procurement and Accountability		9–14
Idukki II Hydroelectric Project, India - Aid-Trade Linkages		9–17
Tanzanian Wheat Development Programme - Project Team Composition		9–22
Tanzanian Railway Projects: Morogoro Workshop, Locomotive Spares Storage, and TRC Steel Rails - Operational Viability		9–25
Lower Solo River Feasibility Study, Indonesia - Planning and Approval		9–27
Lycée professionnel hôtelier d'Abidjan - Reporting and Accountability Relationships		9–29
Wheat Development in Zambia - Evaluation and Follow-up		9–35
Exhibits		
9.1 Food Aid Planning		9–8
9.2 Phases of Project Management		9–19

9

CANADIAN INTERNATIONAL DEVELOPMENT AGENCY

Overview

9.1 The primary objective of CIDA is the delivery of aid to selected Third World countries to assist in their social and economic development. Canadian aid takes several forms, ranging from capital projects designed to improve infrastructure to grassroots projects directed at the poorest populations. Also, within the context of the needs of recipients, CIDA supports the Canadian foreign policy considerations of social justice, economic interest, global peace and security.

9.2 The Agency's budget of $1.4 billion in 1983-84 is 0.4 per cent of Gross National Product. Official Development Assistance levels are targeted to grow to 0.5 per cent of GNP by 1985-86 and 0.7 per cent by the end of the decade.

9.3 CIDA operates in a complex international environment where the delivery of aid projects is plagued by high risk and the frequent need to rely on other participants. In particular, the social and economic conditions that affect the ability of recipient countries to absorb various forms of assistance are rapidly changing. The Agency does not act independently in carrying out projects in Third World countries. In all cases CIDA relies on the recipient to undertake specific activities and often on the work of other donors either in the preparation of the project or in project implementation. Although CIDA controls its own actions, it can only influence the actions of the recipient countries and other donor agencies. In spite of the difficulties of operating in this environment, CIDA has managed to gain the respect of the other participants.

9.4 In 1979, we reported on the activities of CIDA. At that time our audit identified weaknesses in systems and in bilateral project management. Since then the Agency has taken steps to improve its key systems and has implemented improved procedures for bilateral project management. Some major systems improvements included those relating to strategic and policy planning, financial disbursement and commitment controls, and training and development.

9.5 Undertaking this kind of change over the past five years, while keeping the program operating, has been a challenge requiring dedicated and imaginative staff and management. We have noted significant improvements in almost all aspects of program management and delivery. Our current audit highlights some of these improvements and indicates areas where further change is needed.

Audit Scope

9.6 Our audit of CIDA focused on program delivery with respect to food aid, bilateral projects, multilateral projects and special programs. We examined the management systems and procedures that drive program delivery and ensure corporate memory. As well, we audited the Agency-wide systems – strategic and operational planning, human resource management, financial management, internal audit – that support line managers. Among other procedures, our audit included:

- a review of all food aid evaluation studies completed to date;
- a detailed review, including site visits, of 31 bilateral projects in 10 "core" countries;
- a brief review of another 30 bilateral projects;
- a review of CIDA's Comprehensive Agency Management Plan; and
- discussions with other donor countries and agencies such as the United Nations Development Program, US AID, Sweden's SIDA, and the International YWCA.

Observations and Recommendations

Managing the Agency

9.7 In fulfilling its mandate, CIDA must respond to different and often competing objectives of the Canadian aid program. The Agency operates in a complex environment involving Canadian industry, private organizations, other government departments, international organizations, other donor agencies, recipient country governments and non-governmental organizations.

Program Structure

9.8 CIDA delivers aid through four major program components: Bilateral; Multilateral; Special Programs; and Food Aid. All program components are directed primarily at facilitating the efforts of developing countries to aid themselves. As well, Bilateral aid often provides an economic tie between the aid program and the Canadian resource base; Multilateral funds provide untied support to international aid agencies of which Canada is a member; Special Programs fund Canadian and international organizations delivering aid at the grassroots level in recipient countries; Food Aid provides both humanitarian and development assistance through food transfers.

9.9 The types of operation needed to carry out each of these programs are different. Fundamental differences in the nature of these programs complicate the management of the Agency. To maximize its effectiveness, CIDA prepares and communicates policies and strategies, translates them into operational plans as required by the Policy and Expenditure Management System, and eventually turns them into cash, commodities, goods and services to be delivered to recipients. The management of this process and the documents that emerge are key to the Agency's success.

Strategic and Operational Planning

9.10 CIDA has a process in place to prepare strategies and policies for the approval of Cabinet. This process gathers information from the various program branches and other official development assistance agencies for review and development of options. Approved strategies and policies are communicated to managers throughout the Agency. We found this process to be working satisfactorily.

9.11 Part of the strategic and operational planning process is the development of the Indicative Planning figures used to plan long-term cash flows and assess budgetary implications of aid activities for the principal countries which are recipients of bilateral aid. These forecasts are appropriately calculated and communicated to country program managers. The Indicative Planning figures cover a five-year period and are updated annually.

9.12 CIDA's seven operational vice-presidents share responsibility for operational planning. We found that the Branch Strategic Overviews are appropriately linked to the Agency Strategic Overview and that the Branch overviews are translated into work plans. At the request of the Comptroller's Branch, material is prepared by all branches for the Multi-year Operational Plan and Main Estimates and constitutes a compilation of branch operational objectives and spending plans. The Multi-year Operational Plan is prepared for Treasury Board approval; it is not a detailed, action-oriented plan for the line managers.

9.13 Work plans are intended to be a means of communicating operational targets and service needs throughout an organization. The plans should provide a framework for day-to-day decisions and regular monitoring. We noted that the work plans descriptions of goals are clear but the action required and costs have not been documented. In addition, CIDA has not provided the framework needed to co-ordinate the activities of the various delivery and support branches. There is no Agency roll-up of intended action to ensure compatibility and cost effectiveness of such action.

9.14 **The Agency should ensure all Branch work plans pay greater attention to the development of specific action plans and, where appropriate, that such plans are costed and communicated.**

> *Agency response: Agreed. The Agency is currently improving further the linkages between its strategic and multi-year operational plans and annual work plans and will pay particular attention to ensuring that, where reasonable, work plans include the relationships between activities, costs and schedules. The communication of these plans will also be addressed.*

9.15 The Country Program Review is an operational plan done every three to five years for each of the 31 countries in which CIDA is most active. These documents are considered by CIDA to be the framework for planning and evaluating its activities within recipient countries.

9.16 Although this is a complex and costly exercise, CIDA does not require formal planning and documentation of the Country Program Review process. Without a plan, adequate consideration cannot be given to critical factors and user requirements. Also, information gathering is not timely, and managers cannot be sure of the integrity of the information. For example, information was not consistently obtained from the resource specialists and/or the field officers at Posts.

9.17 The Country Program Review is an assessment of the current situation and, in the more recent documents, a plan for the future. As a presentation of the current situation, however, there is difficulty in obtaining valid data. Desk officers obtain some information from international sources but, in many cases, information is just not available. The primary functions of the Country Program Review are to obtain approval for the program to be undertaken and provide direction to project and field officers. We found many of the documents were out of date and did not provide the required direction. CIDA has recognized this problem. Our discussions with other donor country agencies indicated that their attempts to produce Country Program Reviews also have had little success. Conditions are changing too rapidly to permit such a document to have any extended use. Because of costs, other countries have abandoned the complex Country Program Review exercise for a shorter more current review.

9.18 The Agency was in the process of re-examining its expectations from the Country Program Review exercise and how best to provide direction to project and field officers for project identification and delivery. This included the content and format of the Country Program Review.

Comprehensive Agency Management Plan (CAMP)

9.19 In the late 1970s, CIDA was the subject of intensive study of its management systems and procedures by this Office, the Office of the Comptroller General and the Public Service Commission. Priorities and strategies for implementation were established after these studies, and CAMP was set up in January 1980 to correct identified weaknesses. CAMP is important because it is a key instrument for resolving some long-standing issues.

9.20 Several improvements have been implemented as a result of CAMP, particularly relating to financial management and control, preparation of Part III of the Estimates and disbursement and commitment control procedures.

9.21 CAMP consists of 157 projects, 1 of which – the Long-Range System Plan (LRSP) – accounts for 70 per cent of forecast expenditures on the Plan. We examined the process of monitoring CAMP and the results achieved.

CAMP Resource Budget and Utilization

(Person-years and $000,000)

		Budget Estimate January 1980		Budget Estimate March 1984		Utilization to March 1984		Remaining to Complete	
Projects		PY	$	PY	$	PY	$	PY	$
142	Completed or closed	84	4.6	94	3.5	94	3.5	-	-
14	Not completed			45	2.7	28	1.5	17	1.2
1	LRSP (Not completed)	88	9.1	137	14.9	108	10.7	29	4.2
157	Total PY	172		276		230		46	
	$		$ 13.7		$ 21.1		$ 15.7		$ 5.4

Of the 157 CAMP projects, 15 are still active. The 142 other projects have been closed, with most of them completed, although some projects have either been dropped or integrated into the remaining active projects.

9.22 CAMP was implemented by assigning direct responsibility for the projects to appropriate program managers. A CAMP office was established to co-ordinate and monitor implementation.

9.23 The progress of CAMP is monitored and reported quarterly to senior management. The reports for individual projects outline progress to date and targets for the next quarter.

9.24 Our audit revealed that CAMP's quarterly reports to the President's Committee on individual projects were incomplete. Salary costs and person-years used, as reported by the managers responsible, were neither accurate nor complete. In the implementation process, the Agency did not establish an appropriate budgetary control system. Actual person-years and costs were not reported, controlled and monitored against budgets. The majority of the salary costs and person-years reported as having been consumed were estimated, and we cannot express an opinion on their accuracy or completeness. The Agency provided documentation of the progress made in implementing CAMP projects. However, a project-by-project schedule comparing original budgets approved with amounts expended for both completed and incomplete projects was not available. We were advised that the Agency could not produce this schedule because budgets and actual costs were not available on a project-by-project basis.

9.25 For completed projects, we examined the process for ensuring that objectives had been met. In many cases the assessment process was adequate. However, where the process identified a need for more detailed audit and review of objectives achieved, the Agency had not scheduled any formal action.

9.26 The six major projects we examined in detail were one to four years behind schedule. Intermediate milestones had been achieved; however, because the projects are still being implemented, it is impossible to assess fully the extent to which the results may address the original problems.

9.27 Of these six major projects, LRSP will achieve its most important milestone when the Aid Information System becomes fully operational in October 1984. Further improvements and enhancements are planned for completion in 1987.

9.28 In some projects, little progress had been made because the managers responsible claimed they did not have the resources to do the work. In one project, of the estimated 13 person-years and $1,500,000 non-salary costs budgeted, only 2 person-years and $91,000 were reported used.

9.29 CAMP projects are identified as high priority by the Agency, yet implementation activity has been slow, particularly in the six largest projects which remain incomplete. Improvements are required both in monitoring projects and in assessing results.

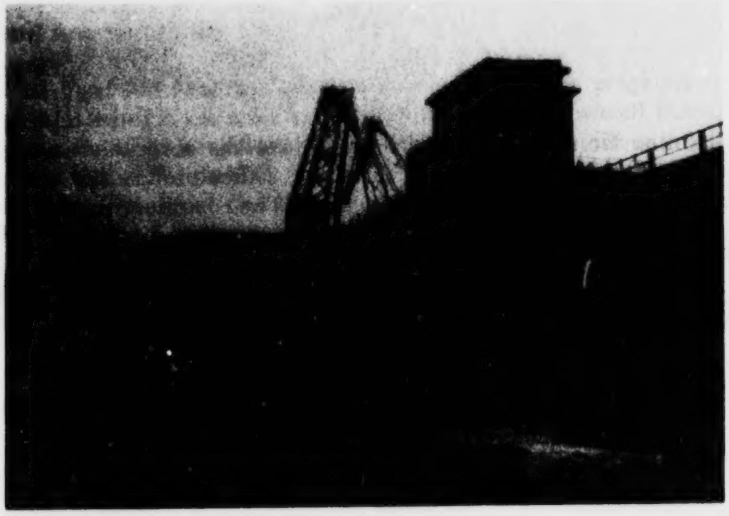
9.30 **The Agency should ensure all remaining CAMP projects are completed as quickly as possible and where appropriate are placed under suitable budgetary control. Furthermore, for all completed CAMP projects where the initial assessment indicated a need for further audit and review, such reviews should be scheduled.**

> *Agency response: Agreed. It is CIDA's intention to review all remaining CAMP projects to assess the need for budgetary control as well as the adequacy of existing budgetary control systems already in place for certain projects. Action has already been taken to ensure that follow-up action is carried out on those completed CAMP Projects requiring further audit or review.*

Food Aid Program

9.31 Over the past five years, the Food Aid Program has cost approximately $1.2 billion. This amount was divided among three programs: Bilateral, $601 million; Multilateral, $571.5 million; and Special Programs, $28 million. Food Aid as a percentage of the Official Development Assistance total has increased from 15 to 18 per cent over the past five years, with a dollar value of $187.6 million in 1979-80 and $321.6 million in 1983-84.

According to international standards, the amount of food procured each year by CIDA provides the annual nutrition for eight million working adults.



Canadian wheat delivered in bulk on the dock in Dakar, Senegal. The wheat will be packed in bags and stored for later pickup by Dakar millers.

9.32 Although new 1984 program objectives have been approved for the Food Aid Program, the objectives at the time of our audit were:

- **Humanitarian assistance** (primary objective): to address the nutritional needs of the poorest segments of recipient country populations.
- **Development**: to complement recipient country agricultural development strategies by generating funds in local currencies from the sale of food locally (counterpart funds) to purchase labour, establish food reserves and support policy reforms.
- **Economic**: to respond to the interests of Canadian producers.
- **Foreign policy**: to be consistent with the general Canadian goals of promoting world peace and stability.

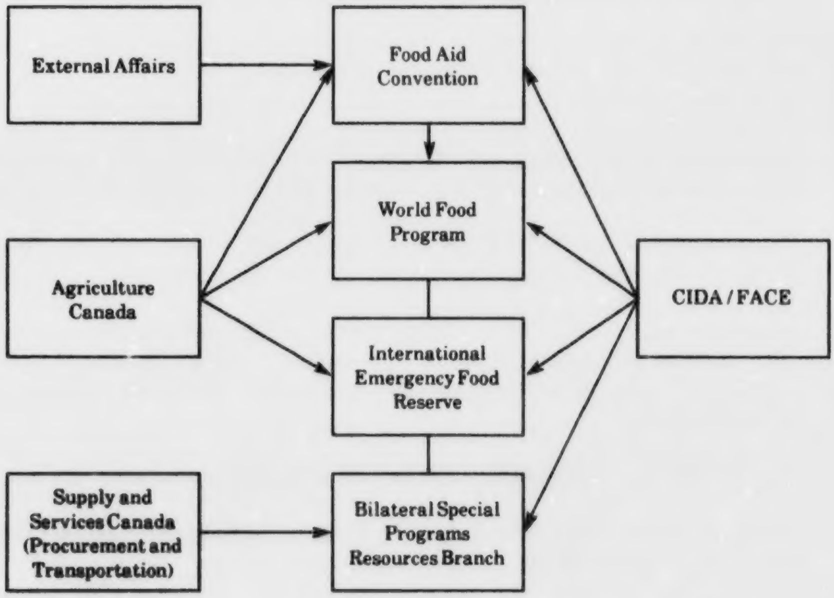
9.33 The Food Aid Co-ordination and Evaluation Centre (FACE) is the organization responsible for co-ordinating the program within CIDA. FACE was established in 1978 within the Multilateral Programs Branch in an attempt to resolve administrative and co-ordination difficulties within the program. FACE has been responsible for improvement in overall administration, but some weaknesses in the programming structure remain. The mandates of FACE and a number of other program participants are currently under review. FACE's role, in addition to being the program manager for Multilateral Food Aid, has evolved to become primarily that of broker, banker, policy maker, and co-ordinator resolving problems arising from decisions made outside the authority of the Multilateral Programs Branch. FACE's current human resource allotment is five professional and three support staff.

Planning

9.34 Planning for the Food Aid Program involves several elements which are different from most other government programs. It is difficult to identify the starting point in the planning cycle since it begins outside CIDA. The co-ordinating and policy-making role of FACE includes providing assistance to organizations responsible for the Food Aid Convention, the World Food Program, and the International Emergency Food Reserve. Principally, these involve the Grains Marketing Bureau of the Department of External Affairs and Agriculture Canada (Exhibit 9.1).

Exhibit 9.1

FOOD AID PLANNING


External Affairs
Food Aid Convention
World Food Program
Agriculture Canada
CIDA / FACE
International Emergency Food Reserve
Supply and Services Canada (Procurement and Transportation)
Bilateral Special Programs Resources Branch

9.35 Within CIDA, FACE prepares an Omnibus Submission to Treasury Board, co-ordinating information supplied by area branches and the Special Programs Branch. Multilateral, Resources, Special Programs, the four Geographical Area Branches and the Program Evaluation Division are all involved in planning, administering, implementing and evaluating the Food Aid Program within CIDA. Outside the Agency, more than a dozen government departments, agencies or commissions, a United Nations committee and various food producer organizations are involved.

Objectives and Accountability

9.36 The Food Aid Program adequately reflects CIDA's program objectives, but accountability relationships are not clearly established for the overall management of the Program. The accountability relationships for this Program are different from other CIDA programs and not well understood within the Agency. Authority for the Food Aid Program is obtained through Vote 35 of the Main Estimates, but guidelines for the Program are derived from an Interdepartmental Working Group paper on Food Aid Policy Recommendations completed in 1978. This document, in conjunction with CIDA's Program Planning Component Review, and the Strategic Overview, constitute the main policy guidelines for the Program.

9.37 Our audit of the Food Aid Program indicated that all projects reflected the broad objectives of the Program. A major issue of concern is the current number of organizations inside and outside CIDA which can bring pressure to bear on the amount and type of commodities used in the Program. Although we identified no abuse of the Program, some evaluation reports questioned the suitability of the commodity mix for the Program in certain recipient countries. In a multilateral context, World Food Program officials indicated they were having difficulty absorbing increasing amounts of non-cereal aid. Canada's food aid basket commodity mix requires 25 per cent to consist of non-cereal aid. This quota has been met.

9.38 A CIDA internal audit report of FACE, Multilateral Branch and the organization of the Food Aid Program focused on activities accounting for 90 per cent of the program resources. The report stated "the food aid program is unique in that there is not a single responsibility centre for all components of the program. FACE's mandate is essentially one of co-ordination, information and advice.... Accountability for the food aid program remains scattered and confused." Although there have been recent attempts to clarify the role of FACE and to strengthen working relationships within the Agency, it is too early to assess their impact.

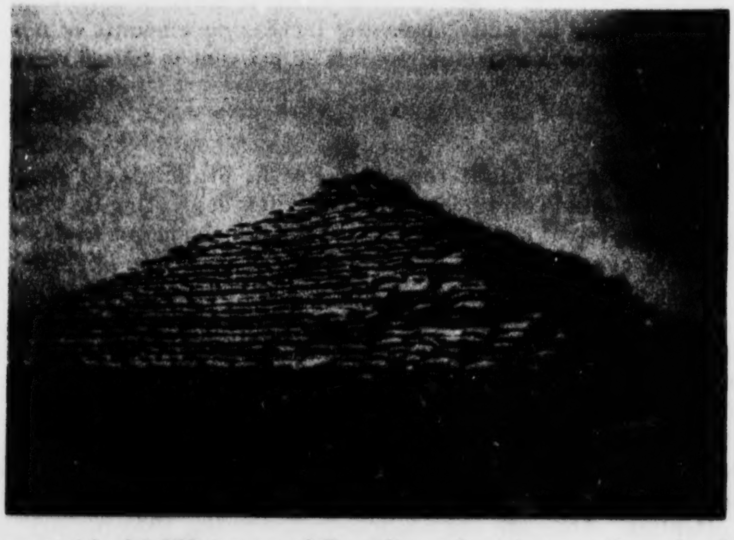
9.39 In practical terms, poor accountability can result in inadequate control of the Program. Food aid does not constitute a major program for most bilateral desks and does not receive close attention. Although the FACE response to the 1983 internal audit report agreed that responsibility for food aid is "scattered and confused", no action has been taken to provide more direct accountability.

9.40 CIDA should address the issue of management accountability in the delivery of the Food Aid Program.

> _Agency response_: *Agreed. CIDA recognizes that many organizational units from both within and without CIDA are involved in the delivery of the Food Aid Programme. Each unit is held accountable for meeting its specific responsibilities and the President of CIDA is accountable for the efficient and effective functioning of the programme as a whole. The management of the Food Aid Programme has been reviewed in the past and is currently the subject of a further review.*

Needs Identification

9.41 During our audit, various donor countries and agencies underlined the difficulty of assessing recipient country estimates of production and overall food resources. Developing countries often lack systems to collect comprehensive and accurate data and the experience and expertise to formulate reliable estimates. Consequently, CIDA and other donors cannot always have a high degree of confidence in recipients' own estimates of their food gap; the difference between need and local production. For the same reasons, it is difficult for CIDA field staff to obtain precise and reliable information on food aid needs.



This pyramid of 1,000 tonnes of Canadian wheat is a portion of a food aid shipment delivered to Niger in April 1983 for sale in local markets by the government. In February 1984, at the country's request, CIDA agreed to its free distribution to drought victims in the Sahel.

9.42 Several multilateral agencies compile and share information on the food situation of Third World countries. For example, the Food and Agriculture Organization circulates regular reports on weather and crop situations, grain imports, and estimated food aid requirements of each developing country. This data is useful to food aid donors, but is not sufficiently detailed to provide a base for planning food aid projects. For example, during our site visit in one African country in January 1984, 48 per cent of the wheat delivered in June 1982 and 100 per cent of the wheat delivered in April 1983 was still in storage. Long-term storage of food increases the likelihood of spoilage. Supplementary data on food requirements are sometimes obtained from other donors, but this is done on an ad hoc and informal rather than a systematic basis. The result is that CIDA does not always have the information it needs to ensure optimum use of Canadian food aid.

9.43 When information on a recipient's food situation is inadequate, two problems can arise. One is that donors may misjudge food aid requirements, and provide too much or too little, or deliver food aid at the wrong time. The other is that, if food aid is provided without an appreciation of its potential impact on a recipient's agricultural sector, there is a danger that in certain circumstances it may be a disincentive to local producers. Analysis of each recipient's food situation is essential to sound planning of food aid projects and requires greater attention than it currently receives.

9.44 **CIDA should investigate ways and means of improving its information on food aid needs in recipient countries.**

> *Agency response: Agreed. The importance of strengthening both CIDA's and the international community's capacity for food aid needs assessment is well understood. Recent steps to improve the situation include commissioning, along with two other major food aid donors, the International Food Policy Research Institute to devise a practical system for obtaining and exchanging food aid information among the food aid community. CIDA is also collaborating with several multilateral and bilateral food and agricultural agencies by participating on food aid needs assessment missions, exchanging reports and data bases, improving methodology and expanding various institutional capacities including those of recipient countries. Within CIDA a more rigorous analytical approach has been adopted to integrate food needs assessments including the logistical aspects of each shipment into the food aid programming procedures. These improvements were spelled out in the Planning documents prepared last spring.*

Monitoring

9.45 CIDA's existing control mechanisms do not ensure adequate monitoring of the implementation of food aid projects. Five organizational units are involved in the implementation of a typical bilateral food aid project. Resources Branch is responsible for purchasing when commodities are obtained from government agencies such as the Canadian Wheat Board. It also plans and co-ordinates shipping arrangements. Supply and Services Canada is responsible for commodity purchasing when this is done through public tenders. It also contracts for transportation. The recipient country receives, stores and distributes the food provided and, when CIDA requires it, deposits money obtained from sales in a counterpart fund to be used for development purposes. The operating branch which planned the project (Special Programs Branch or one of the four Area Branches) is responsible for following up this purchase and delivery process and for monitoring the utilization of the food aid. In some cases, country desks engage outside agencies (such as the World Food Program) to assist with this monitoring. Finally, FACE has an indirect involvement in that it maintains an overview of the implementation of the total Food Aid Program.

Weighing wheat in Bangladesh food aid distribution centre.

9.46 The audit team found that follow-up and monitoring of food aid projects is not always adequate. For example, information contained in the files of one food aid project was six months out of date. Moreover, as of March 1984, the project officer was unaware that the amendment to a 1981-82 Memorandum of Understanding sent to the recipient country for approval in April 1983 was never signed. Notwithstanding improvements in communication among the Area Branches, FACE and Resources Branch, the various actors in the implementation process do not always keep project officers sufficiently informed of their activities. In addition, during our on-site visits we noted that field officers are not always aware of the role they should play in follow-up and monitoring. For example, at the time of our January 1984 visit to a recipient country, we could find no CIDA field officer who had exact knowledge of the status of food delivered in April 1983.

9.47 Each unit which participates in the implementation of food aid is accountable for its own activities. But diffusion of responsibility, combined with inadequate monitoring, has produced a situation in which accountability for the overall process of implementing the

Food Aid Program as a whole is insufficient. The magnitude of the Program, both in dollar value and in its potential to enhance the image of the Canadian aid program, warrants an improved monitoring system to ensure that objectives are achieved.

9.48 CIDA should clearly state the responsibilities of field officers for monitoring the Food Aid Program within recipient countries.

> *Agency response: Agreed. Procedures for identifying responsibilities of field officers are in place but they will be reviewed and strengthened where necessary. CIDA will make sure that the role of CIDA field staff in monitoring the food aid program is clarified and transmitted to all posts.*
>
> *The monitoring requirements and arrangements depend on the purpose for which the food aid is being provided and CIDA's field capacity in the country. For example, the World Food Programme with its resident specialized field network was contracted to monitor nine bilateral food aid shipments in 1983-84. In other countries organizations such as the Co-operative Union of Canada or the Canadian Mission itself are used. While the importance of CIDA's field officers knowing their responsibilities is fully acknowledged, their role in the monitoring process varies considerably as would their detailed knowledge of various shipments. In special circumstances where additional functions have to be performed, posts will be requested to provide such monitoring according to resources available.*

Transportation

9.49 Transportation procedures for the Food Aid Program are satisfactory, but problems persist in implementing transport. Transportation has been consistently defined as a problem area for CIDA. Part of the reason is that transporting food presents special problems of spoilage, handling, and timing of shipments. The Resources Branch Transportation Section is in charge of most bilateral and emergency food aid transportation, although the actual contracting for transportation is carried out by the Overseas Traffic Services of Supply and Services Canada. Some recipient countries make their own transportation arrangements.

9.50 For the past several years, late approval of the main planning documents, which is beyond CIDA's control, has seriously hampered efforts to improve the efficiency and effectiveness of transportation. Insufficient time was left to investigate alternative shipping methods such as shipping from the west coast rather than the east, or pooling shipments. Also shipments were often made in the winter season from ice-prone ports. This involves considerable risk of shipments being ice-bound or damaged. While winter shipments may be unavoidable in some instances, higher risks result in higher shipping costs. Since 1983, however, significant improvement in the planning and approval process has been achieved. Earlier approvals should contribute to better transportation planning.

Evaluation

9.51 Since 1979-80, about 20 project evaluations or reviews of bilateral food aid projects have been completed. Although the results of these evaluations have been used to alter specific food aid projects, there is no formal mechanism to ensure the integration of findings from individual studies as a means of improving overall management. Not all managers were aware of completed evaluations. Further, there was no central file of bilateral food aid evaluation reports.

9.52 FACE involvement in bilateral food aid project evaluations has been ad hoc, with different levels of participation. One reason for establishing FACE was to ensure a process of periodic review of food aid transfers. However, CIDA's overall evaluation policy subsequently assigned responsibility for country and project level evaluations to the operating branches. For this reason, evaluation of bilateral projects has not been a major focus of activity for FACE.

9.53 Generally, CIDA as an agency has given a high priority to food aid evaluations; examples include the current corporate evaluation and the upcoming second institutional appraisal of the World Food Program. In these two major evaluation activities, FACE has been fully involved. However, the absence of a formal mechanism to incorporate or assess key findings weakens the overall management of the Food Aid Program.

9.54 **CIDA should review the current corporate policy on food aid evaluation with special attention to the use of findings.**

> Agency response: *Agreed. The importance of linking evaluation activities to other parts of the programme cycle such as country programme reviews and project proposals is fully accepted. This is already being done in several instances. CIDA generally combines its evaluation activities with forward-looking appraisals which take into account future food aid programming. This pragmatic approach allows for immediate benefit to be derived from all evaluation activities while broader lessons are obtained from their circulation, discussion and application through the branch strategic plan and other policy documents. The corporate evaluation of food aid is entering its second phase and is analysing the results of all country-level evaluations in order to apply them to overall programme planning and management questions. Ways of further strengthening the application of these findings are under ongoing review.*

Case Study - Skim Milk Powder

Issue: Procurement and Accountability

One Treasury Board condition for international aid requires that "the food stuffs or commodities are to be purchased by or on behalf of CIDA at the prevailing international

price". Prior to a 1982 decision on pricing procedures for skim milk powder, CIDA was under pressure to assist the Canadian Dairy Commission (CDC) to maintain its price position.

Our estimates indicate that, between 1979 and 1982, approximately $4.9 million was paid to the CDC by CIDA in excess of prevailing international prices for skim milk powder (SMP). Historically, it appears that a premium of approximately $200 a tonne has been paid by CIDA to the CDC in excess of the prevailing international prices.

This situation was recognized by CIDA and FACE, and they devised a new negotiating strategy. This strategy was used in 1982-83 and resulted in decreased costs of $2.2 million. The current procedure for establishing the price of SMP for CIDA is based on a weighted average of CDC export sales for the quarter prior to the negotiating period. This is an acceptable practice for establishing an international SMP price.

An additional factor, however, involves the cost and need for fortifying SMP with vitamins A and D. This cost is added to the basic price of SMP charged by CDC. The base price per tonne for the fortification of SMP charged by the CDC has increased from $40 in 1980 to $149 in 1984. Data on file in CIDA and confirmed with private Canadian dairies, other donor countries, an aid recipient dairy producer and the World Food Program indicated the price of fortification generally should not exceed $20 a tonne. Our estimates of CIDA payments in excess of international prices (assuming 70 per cent of all SMP is fortified) are:

1980-81	$ 110,000
1981-82	603,000
1982-83	1,200,000
1983-84	1,700,000
Total:	$ 3,613,000

The CDC price of fortification is based on the cost of labour for debagging, bagging, transporting, handling and mixing. The method of fortification is to mix in the added vitamins using a blending machine. This method does not ensure a homogeneous distribution of vitamins and hence reduces the quality of the final product. The method of fortification most frequently used in Canada is to add the vitamins during the spray-dry process as the powder is created. CIDA SMP bags indicate that the spray process is used, but the CDC billing rate for added vitamins is based on the more expensive mixing process.

A supplementary consideration of the fortified SMP program deals with the general effectiveness of the fortified product. Most data on the effectiveness of fortification indicate that a maximum shelf life of about nine months is attainable, but the vitamin deterioration process begins to take effect after about three months. Using CIDA's current monitoring system, there is no assurance that fortified SMP will be used soon enough within this time frame to justify the cost of fortification. There is no product dating code included on the bag markings.

The last issue associated with SMP concerns the current woven polypropylene bag used for shipment. Stevedores in Third World countries generally use hooks for loading and unloading. The hook penetrates the plastic liner in the bag, making it possible for moisture to get into the product, rendering it unfit for consumption. The holes in the plastic liner cannot be detected because the woven fabric of the bag closes after the hook is removed leaving no trace. Paper bags used by other donor countries are marked "Use No Hooks". The Canadian bag contains no such markings.

CIDA is aware of these problems and is attempting to resolve them.

Bilateral Program Management

9.55 The Bilateral Program is managed through four Geographic Branches (Americas, Anglophone Africa, Asia, and Francophone Africa). These Branches co-operate with developing countries and regional institutions in programs and projects designed to foster economic and social development. The work includes transferring Canadian goods, services, technology and expertise. Branch expenditures, excluding food aid, amounted to $3 billion over the five years from 1979 to 1984. With food aid, the total was $3.6 billion.

9.56 Projects are the main delivery mechanism of the Bilateral Branches. In 1979, there were approximately 2,500 active bilateral projects; this was reduced to 1,200 active projects in 1984. Projects that were essentially complete but not closed accounted for much of this difference.

9.57 Projects are divided into four stages – identification; planning and approval; implementation; and evaluation (see Exhibit 9.2).

9.58 The Bilateral Branches are supported by the Resources Branch which provides technical expertise in project planning and execution, manages the process of selecting Canadian firms to implement CIDA projects, provides procurement planning and monitoring advice and recruits co-operants. CIDA estimates the volume of procurement at $750 million annually; service contracts were $147 million in 1983-84. Experts on the staff of the Resources Branch include specialists in such fields as agriculture, water and sewage, public health, transportation, telecommunications, forestry, fisheries and energy.

Aid and Trade

9.59 As well as the primary objective of development assistance, an objective of many bilateral projects is to generate economic ties with Canada. Aid is a possible entry mechanism for further trade with a recipient country. Many CIDA projects present an opportunity to demonstrate to recipients the quality and competitiveness of Canadian goods. Equipment should be appropriate to the recipient country's environment and obtained at the best price possible. Problems in aid projects may compromise future trading possibilities with that country.

9.60 In our discussions with other donor countries, we found the links between aid and trade were being emphasized. Like Canada, these countries were able to see the link between infrastructure being developed in Third World countries and potential trade opportunities.

Case Study: Idukki II Hydroelectric Project - India

Issue: Aid-Trade Linkages

From 1969 to 1976, CIDA participated in Idukki Phase I which consisted of constructing three dams, two penstock tunnels, a switchyard and an underground powerhouse with three 130-megawatt turbine-generator sets. CIDA was invited to participate in Phase II because of the good relationships established during the first phase.

Installation of turbine-generators progressing on schedule in the Idukki II project in India.

Idukki II encompasses:

- **designing, procuring, installing and commissioning three turbine-generator units;**
- **supplying powerhouse and switchyard ancillary equipment, associated civil works, the steel lining and grouting of a penstock tunnel;**
- **completing a water management study and transferring technology relative to all technical and managerial aspects of the project; and**
- **monitoring the dams.**

A Canadian firm of consulting engineers, paid out of Grant funds, provides project management services, but all manpower is provided by India.

CIDA followed good management practices in planning and implementing the Idukki II Hydroelectric Project in India. This $56 million project shows every sign of achieving its objectives on time and under budget.

The project is responsive to India's ability to use and maintain the equipment and to the availability of Canadian expertise and machinery. CIDA, the Kerala State Electricity Board (KSEB) of India, and the consulting engineer all participated actively in planning the project. The planners considered the successes and weaknesses of the first phase and ensured that the technical aspects of the projects were thoroughly addressed.

Adequate control of the implementation of the project has been ensured through several feedback mechanisms, such as monthly progress reports, annual review meetings and frequent site visits. The project has benefited from the continuity of personnel at CIDA Headquarters, the Post, the KSEB and the firm of consultants. Problems are dealt with promptly and effectively, and the project is progressing on schedule.

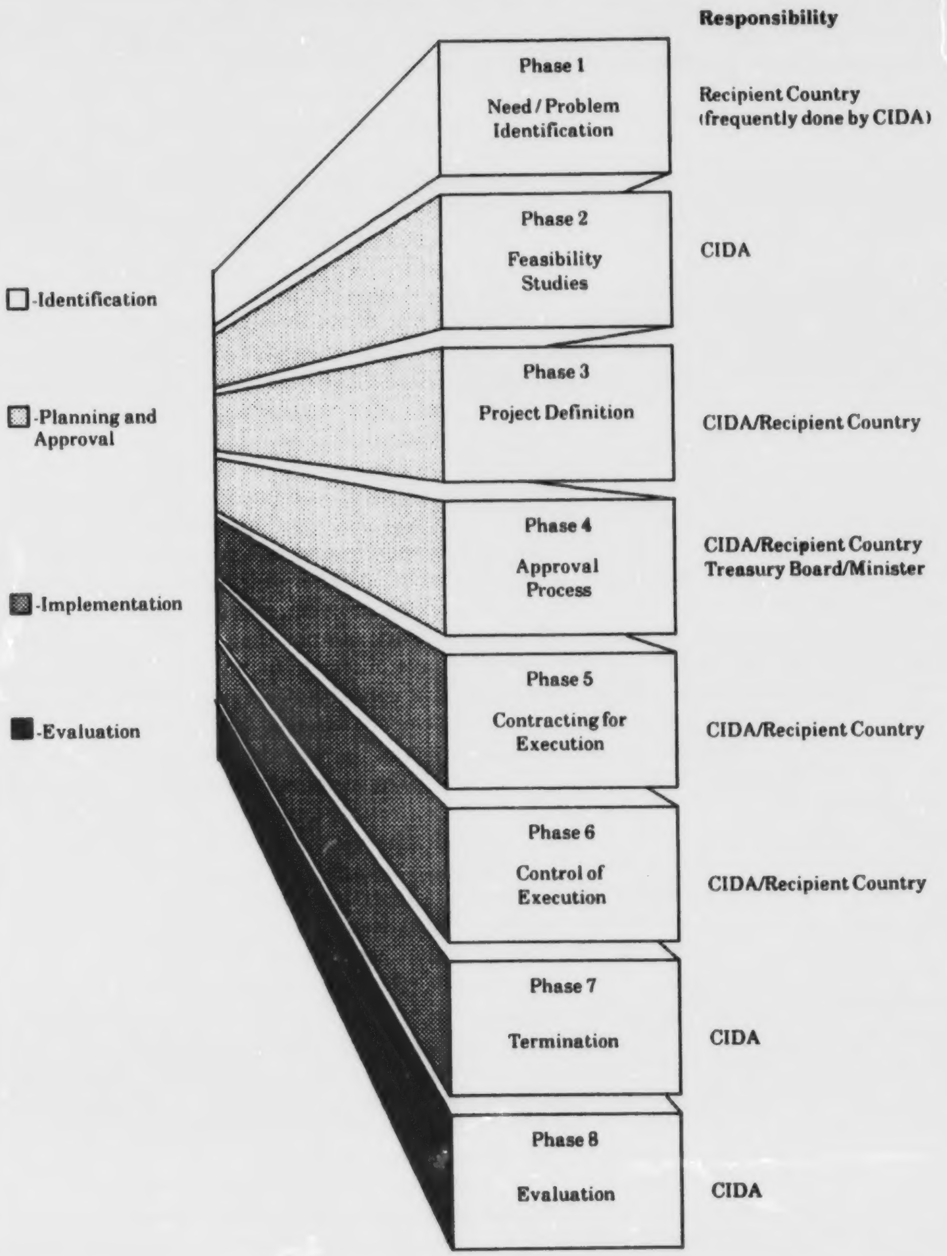
Partly because of the success of Idduki, India has asked Canada to participate in the Chamera Hydroelectric Dam Project. CIDA and the Export Development Corporation have financing for the project approved at $250 million and $400 million, respectively. The total estimated value of the project is $1.3 billion. All offshore procurement of equipment will be from Canada. India will finance the local costs.

Project Management

9.61 Project Management is shared by four groups – three Canadian and one recipient country. The CIDA Headquarters project team is made up of a team leader, sectoral specialists and a financial adviser. At the Canadian Embassy in the recipient country, a field officer provides the link between the project team, the recipient country and on-site project activities. The on-site project implementation team is usually a Canadian company, institution or group of co-operants. The recipient country also plays a major role in managing projects and usually must manage significant financial and human resources.

Exhibit 9.2

PHASES OF PROJECT MANAGEMENT


Responsibility
Phase 1
Need / Problem Identification
Recipient Country (frequently done by CIDA)
Phase 2
Feasibility Studies
CIDA
Phase 3
Project Definition
CIDA/Recipient Country
Phase 4
Approval Process
CIDA/Recipient Country Treasury Board/Minister
Phase 5
Contracting for Execution
CIDA/Recipient Country
Phase 6
Control of Execution
CIDA/Recipient Country
Phase 7
Termination
CIDA
Phase 8
Evaluation
CIDA
☐-Identification
▨-Planning and Approval
▨-Implementation
■-Evaluation

9.62 We found four main problems with the way in which projects were managed in CIDA:

- the structure to manage projects was essentially the same, regardless of size or complexity;
- the project team leader located at Headquarters did not have sufficient technical support to manage the project;
- the field officers were not monitoring projects adequately on site; and
- information used to make project decisions was not always accurate, complete or timely.

9.63 **Structure.** Different projects often require different structures. Large, complex projects should have a project monitor on site, ready to solve problems as they arise and safeguard CIDA interests. Small or straightforward projects can be managed in a more remote way with limited reviews and site visits. CIDA usually manages all its projects with limited reviews and site visits.

9.64 **Project teams.** The composition of the Headquarters project team was appropriate, but the key function of leadership was not appropriately supported. The bilateral officers are knowledgeable about the economic and developmental needs of the recipient country. This knowledge is important in determining whether the project is needed. The actual management of larger or complex projects, however, requires a more technical knowledge of project inputs and outputs. For example, the CIDA project leader for a project to rehabilitate a railway line needs to have access to technical advice concerning the problems that may arise and the implications of consultant recommendations. Ideally, the project team leader should be both a good project manager and a technical expert. However, in view of the diversity of CIDA projects and the scarcity of such project leaders, CIDA operates with generalists as team leaders. The technical expertise is provided by sectoral experts.

9.65 During the project planning phase, the critical question of the amount of technical knowledge required to manage the project from CIDA's perspective needs to be addressed. The project leader can then be selected based on the availability of technical expertise and his or her ability to manage the project. In our review of CIDA projects, we found little evidence of this type of assessment.

9.66 We found sectoral experts were not available to provide a sufficient level of service to projects. Sectoral experts take care of an average of 20 projects, making in-depth reviews of project reports and timely site visits almost impossible. There are 65 sectoral experts compared to 150 bilateral project officers. In some instances, CIDA hires consultants to provide sectoral expertise to the project team. This arrangement further diffuses accountability and responsibility for project delivery, since the consultant reports to a sectoral expert who reports to the project team leader.

9.67 In Part III of the Estimates, the program description states that "certain measures are taken to ensure that activities are conducted in the most efficient and effective manner possible." Thus, CIDA is responsible for the process of delivery and for ensuring its commitments to project outputs are achieved in an efficient manner. This approach means that CIDA has responsibility for the quality of the end product and for making sure that trade considerations are taken into account. Responsibility for achieving good project results depends in large part on the consultants implementing the project. The CIDA project team facilitates the process of project implementation and intervenes, when necessary, to ensure project results.

9.68 **CIDA should examine the roles of the bilateral and sectoral officers on project teams and ensure the leadership for the project has sufficient managerial and technical support and that the division of responsibilities and the staffing of the project teams, as between sector officers and bilateral officers, are commensurate with the tasks that need to be carried out.**

> *Agency response: Agreed. CIDA is presently examining the functioning of the project teams and the Professional Services Branch will soon put forward a proposal to ensure that the necessary technical expertise be adequately provided. If necessary, opportunities to secure such professional services under contract will be expanded, a formula which would also offer the advantage of obtaining up-to-date expertise from the private sector.*

9.69 **Field officers**. We found the procedures to hire consultants and co-operants to work on project sites were lengthy but adequate. In general, the qualifications and experience of the Canadians assigned to projects appeared to be appropriate in relation to the work to be done.

9.70 Requirements for monitoring by field officers vary from project to project. Aid officers in the field do not always have access to sufficient technical expertise to monitor highly technical or large projects. We noted significant problems at Posts in monitoring CIDA-financed projects. Many projects require field officers to have reasonable exposure to sectoral issues or access to technical support in order to adequately resolve operational problems as they occur. These problems are difficult to address unless the officer already possesses a depth of knowledge in the field. Delays result that affect the progress of the project as clarification is sought from Headquarters.

9.71 In addition, the field officer reports to CIDA through the Canadian Ambassador. CIDA is responsible for selecting or ratifying the selection of field officers. A stream of Foreign Service Officers has been established within External Affairs to provide the human resource base for staffing aid positions abroad.

9.72 **CIDA should ensure that field officers are provided with the level of technical and administrative support needed to monitor projects during implementation.**

Agency response: Agreed in principle; a policy paper has just been issued on the options available to CIDA management in terms of creating special administrative units in the field which would provide the technical back-up needed by the field staff. In addition, a recent directive, which stipulates that projects should be implemented under a single executing agent, will facilitate the monitoring functions of field staff.

Some host countries may be reluctant to the establishment of such special technical units: in these cases, alternative solutions will have to be identified.

9.73 **Staff turnover and project information.** CIDA projects continue to suffer from high turnover of project officers and field officers. The Agency is aware of the problem and is examining and implementing staffing options to resolve it.

9.74 Staff changes at Posts are neither smooth nor satisfactory. Furthermore, the time to implement a project exceeds the normal time period of an appointment at Headquarters and a posting in the field. Transfer of responsibility from one officer to another does not always include a detailed briefing. Documents and files are not always readily available or properly structured to assist officers in familiarizing themselves with projects. For example, in a $25 million project, the country program manager, the project team leader, the principal resource officer and the field officer were all changed within two years, contributing to project delays and other project management difficulties.

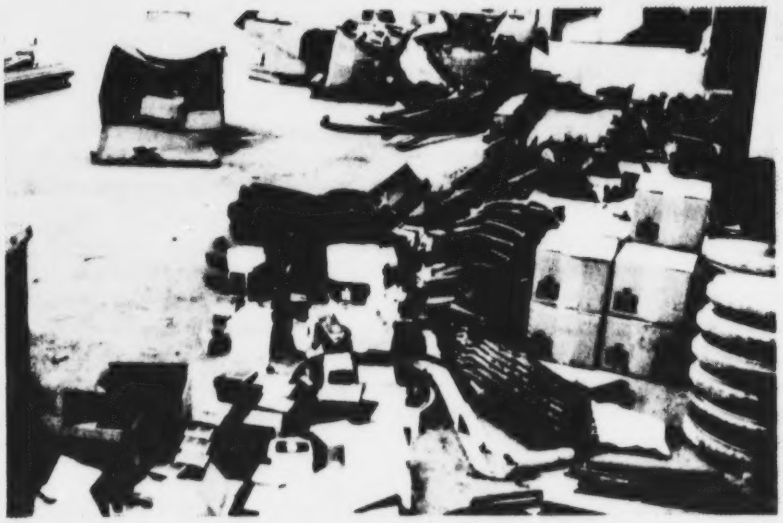
Case Study: Tanzanian Wheat Development Programme

Issue: Project Team Composition

The Tanzanian Wheat Development Programme is a continuation of a project that began in 1969. The original project had two goals: to develop an adaptive research capacity in Tanzania; and to provide Canadian advisers to assist in wheat production. The objectives of the later phase of the project were to continue previous initiatives in research and production and to provide technical assistance, training and machinery appropriate to large-scale farming.

Wheat is an essential commodity for Tanzania. The six farms now in operation with Canadian assistance produce about 40,000 tons of wheat annually, supplying about 40 per cent of the country's needs. The wheat is sold through the state-owned National Milling Corporation. Canada's total contribution to the project is approximately $52.5 million.

Agriculture Canada and SIAG Incorporated were the implementing agents for CIDA in the wheat development project. However, there are four other major participants in the project. This has created difficulty in establishing clear roles and responsibilities. Agriculture Canada and CIDA Headquarters are responsible for project control, but the location of staff in Ottawa and Hull, rather than on site, makes it difficult to control such a complex project.



Spare parts shipped to Tanzanian wheat farming project during previous years sit on the floor of the recently opened Service Centre.

The implications of poor control have appeared throughout the last four years of the project. The tendering process for developing infrastructure on the Tanzanian farms took roughly two years to complete. CIDA carried out this work, not Agriculture Canada. The procurement process for machinery and equipment was slow and not co-ordinated with on-site activities particularly during start-up. Spare parts for tractors and other farm machinery arrived on site without adequate storage facilities available. As a result, it was difficult to establish appropriate inventory procedures, and some spare parts were rusted, lost or stolen.

Problems of poor co-ordination occurred in designing and constructing housing and main buildings for the research station. This work was originally performed by a consortium of firms, but performance was poor. In March 1983, CIDA conducted an evaluation of the project that confirmed the problems. A consultant was subsequently hired by CIDA to monitor problems and costs associated with the project. Agriculture Canada was assigned management control by CIDA in 1984, and an on-site director was appointed in mid-1984.

Although the wheat development project achieved measurable success in training Tanzanians and increasing wheat production, CIDA had problems in managing the project. Accountability patterns were weak and diffuse. There were weaknesses in both the provision and storage of spare parts. Delays in procurement, design and construction seriously affected results in the research and infrastructure components of the project.

Identification of Need

9.75 CIDA projects generally respond to the development needs of recipient countries.

9.76 Current methods of project identification place maximum emphasis on CIDA to initiate, plan and gain approval for a project. In theory, the recipient country should develop its own proposals; however, in many cases, it has neither the funds nor the technical competence to do so. Nevertheless, receiving aid should not be a passive activity. There is a need for the recipient country to demonstrate a commitment to the project to help ensure that the development objective is achieved and for CIDA to obtain the fullest possible participation of the recipient country in identifying projects.

Planning and Approval

9.77 The Agency has made progress in introducing project management techniques. The results are better planning documents and information for senior management during the planning stage.

9.78 Bilateral officers generally follow the planning procedures documented by the Agency. The procedures require a series of documents, including feasibility studies, to be prepared that identify the salient characteristics of a project in relation to recipient country development objectives and satisfy CIDA's need for assurance on the appropriateness of the project in light of Canadian aid objectives. While the approval documents focus on key elements essential to CIDA administrative control, insufficient attention is directed toward assessing the operational viability of a project.

9.79 Determination of operational viability requires an analytical assessment of the major component parts of a project. It entails a review of risks and the identification of options to address critical factors or assumptions affecting CIDA's ability to implement a project. With every project, assumptions are made concerning available resources, timing, Canadian capability, recipient country capability, and third party participation. The validity of these assumptions needs to be challenged prior to approval and options identified to resolve problem situations when they occur. Also, monitoring arrangements need to be set up to inform CIDA on a timely basis of any significant changes in project conditions, and contingency plans have to be brought into play as appropriate.

9.80 CIDA currently identifies critical factors in the project identification and approval process. However, these critical factors are not assessed with a view to developing an Agency response to a likely contingency or supported with sufficient analysis to facilitate approval. Furthermore, Project Review Committee recommendations prior to approval are not always acted on. Monitoring procedures to provide an ongoing review of critical factors are not established or communicated. Because operational viability is not adequately addressed, identified projects tend to proceed through the full planning and approval cycle with minimal likelihood of rejection on grounds of operational non-viability.

9.81 Many projects involving complex variables can never be fully assessed in relation to specific details. Unforeseen contingencies are a constant factor in Third World development projects. This is widely understood by CIDA personnel. CIDA's planning and approval process generates good descriptive details for projects. However, descriptive details of a project do not constitute an analysis of key factors nor do they provide adequate guidance for purposes of project monitoring. Reliance on descriptive material which does not assess operational viability will not improve overall project performance.

9.82 CIDA should improve the process of assessing factors critical to operational viability and identify options to address these issues.

> *Agency response: Agreed. At the project approval level, CIDA will seek to strengthen the role of the Plans of Operation Review Committee so as to ensure that factors critical to the viability of a project are clearly identified and assessed. CIDA will also restate the responsibility of members of the different approval committees to ensure that critical assumptions are assessed before recommending or approving a project. CIDA will also ensure that the "logical framework" and the Plan of Operations are reviewed at the critical milestones of major projects.*
>
> *On the other hand, CIDA disagrees that options should be identified at the project approval stage in case critical assumptions fail to materialize. It is CIDA's view that there are several critical assumptions affecting the life of a typical multi-year project and it would not be cost-effective to develop, at the start of the project, scenarios for each potential problem.*

Case Study: Tanzania Railway Projects: Morogoro Workshop, Locomotive Spares Storage, and TRC Steel Rails

Issue: Operational Viability

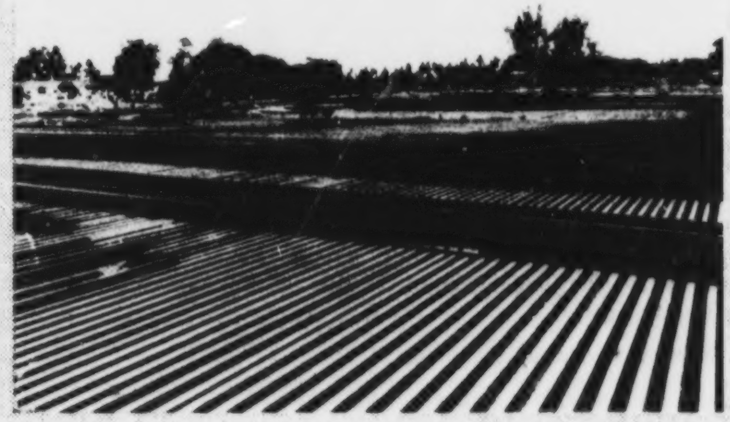
Since the early 1970s, CIDA has had substantial involvement with the Tanzania Railway Corporation (TRC). Two projects, the Morogoro Workshop and the track rehabilitation project, have used $31 million to date. These projects illustrate the extent to which assessment of operational viability is a key element in the outcome of a project.

The Morogoro Workshop was intended to provide a TRC facility to overhaul railroad locomotives. The justification for this project included the urgent need to protect the value of 20 locomotives provided by CIDA in 1972. These locomotives were nearing the end of their normal service period and required a major overhaul within the next one and one-half years, 1977-79. The overhaul of the locomotives entailed a number of supplementary activities:

- training personnel;
- providing spare parts; and
- providing adequate accommodations.

These activities needed to be properly assessed for operational viability in the planning stages, and potential difficulties should have been identified. The first difficulty encountered in the project was the lack of accommodation for trainees, causing problems with hiring and retaining trainees. Because of declining finances, TRC was unable to provide housing and thus trainees, a key component essential to the success of the project. However, CIDA's plans were not sufficiently flexible to provide for the eventuality of Tanzania not being able to fulfil its commitment to hire and retain a sufficient number of suitable trainees. CIDA is now planning to fund the construction of housing for 100 workshop staff and a 50-person hostel for trainees. A condition of implementation is the confirmation of hiring a sufficient number of staff and trainees to use these facilities. Until workers are recruited and trained, the Morogoro Workshop can not operate to its expected capacity. The output from the date it began operations in May 1982 to February 1984 has been 3 locomotives overhauled compared with the expected annual output of 36, and some running maintenance and accident repairs. A new training project is planned to cost about $5 million.

At the same time that CIDA was aware of the difficulty that TRC was experiencing in financing its share of the development agreement, CIDA funded the purchase of $5.8 million in spare parts. Because of the lack of available storage facilities, the spare parts were warehoused in Dar Es Salam, about 120 miles away from the Morogoro Workshop where the locomotive overhauls are carried out. This has caused considerable difficulty in completing repair work. Additional facilities at Morogoro are being planned and will cost about $650,000.



Steel rails delivered to Tanzania Railway Corporation in April and May 1978.

TRC in 1977 intended to re-lay 180 miles of railroad track. The rails were provided by Canada in April and May 1978 at a cost of $14.2 million. However, TRC was unable to provide adequate ties for the track provided by Canada. The result to date is that only 52 miles of track have been re-laid, 12 miles of track have been stored in Dar Es Salam since 1978, and 116 miles are stored alongside the railway lines waiting for the ties.

At the time of our audit, CIDA had not established procedures to assess the operational viability of these projects. CIDA is currently planning to spend an additional $40 million in future assistance to the Tanzania Railway Corporation to fully realize the original objectives of these projects.

9.83 The elapsed time in planning a CIDA project is excessively long. In all Bilateral Branches, we found that, on average, three to four years was the time taken to move from identifying a project to mobilizing it. In addition, a draft "Final Report in the Indonesian Program Delivery Study", completed by the Bureau of Management Consulting on 29 July 1983, indicated that the average elapsed time for the eight projects reviewed, from the Indonesian request to consultant mobilization, was 5.4 years. One result of this lengthy planning process is that many recipient countries hesitate before seeking Canadian participation in urgent or high profile projects. Also, delays in planning lead to shifting terms of reference brought about by changing personnel and changing conditions. In one project, this period reached 10 years as CIDA negotiated terms with the recipient country.

9.84 Several factors currently influence the length of the planning and approval process. The planning and approval steps are carried out sequentially, even though there are opportunities to undertake at least some of the steps concurrently. At times, information is requested even though it is not required for a particular step in the planning and approval process. However, project officers do not have sufficient latitude to determine where it would be appropriate and feasible to eliminate or combine some of the steps in the planning and approval process.

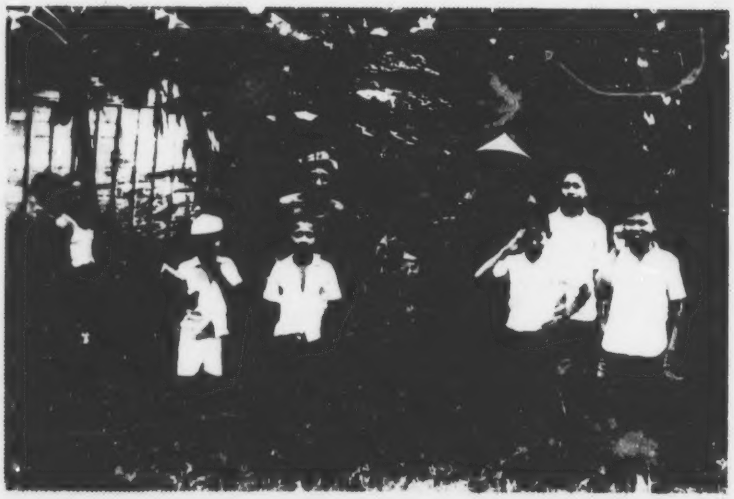
9.85 CIDA is aware of the problem of the excessive length of time required for project planning and approval and has started to take corrective action.

Case Study: Lower Solo River Feasibility Study - Indonesia

Issue: Planning and Approval

In 1977, CIDA prepared a Project Identification Memorandum proposing a feasibility study of the Lower Solo River Basin in Indonesia. This was an area subject to annual flooding with consequent loss of property and agricultural production. In 1978, a consultant completed a pre-study of the potential feasibility study. The pre-study identified the primary terms of reference for the project and other related aspects of the Lower Solo River Basin that could be integrated into future planning initiatives. One of

the key factors in the Lower Solo River Basin was the possibility of constructing a dam across the river. Unfortunately, the dam will require relocating approximately 250,000 local residents. This prospect has created a measure of political uncertainty surrounding the final decision on the dam. Without a clear statement about the dam by the Indonesian Government, however, CIDA has not been able to establish final terms of reference for the project. Nevertheless, the Agency continued to pursue the project through all phases of planning and approval.



Some of the 250,000 residents of the Lower Solo River area in Indonesia.

The final unresolved terms of reference resulted in a decision to engage an engineering firm to establish its own work plans and schedules on site at a cost of $10 million, approximately double the original estimate. The engineering team, which was to complete the feasibility study, was mobilized in 1983, almost six years after the initial identification of the project. In the absence of a final decision concerning the dam, the current work of the engineering team is directed toward the study of other aspects of the Lower Solo River Basin.

Implementing Projects

9.86 **Reporting and accountability relationships.** Clarity in reporting and accountability relationships established in the planning documents, job descriptions and project descriptions, were not maintained in the operational relationships that evolved over the life of projects. Environmental factors make communication difficult, and often delegated authority is not sufficient to allow timely decision making. Further, on some projects, the formal communication process was inordinately complex, making it difficult to establish and maintain accountability. For example, one project had three separate consulting firms, their own headquarters, CIDA Headquarters, the recipient country and the Canadian Embassy involved in project management. When it is necessary to have so many participants, leadership and accountability must be clear. However, in this case, the leadership was not clear, and communication among the parties was not adequate. This compromised the timeliness of project delivery.

9.87 Resolution of operational problems in the field has sometimes not been well handled by CIDA. Currently, the major responsibility for projects rests with the CIDA Headquarters officer. Headquarters project officers, however, often do not have enough knowledge of the project, problems, or circumstances to offer appropriate responses. Lack of knowledge is also compounded by distance and the difficulty of interpreting telex messages that may be unclear. Technical assistance is rarely available on short notice at Posts or Headquarters. As well, Post project officers view their role as subservient to Headquarters project officers and, in the current context, prefer to have most decisions made by Headquarters.

9.88 Examples of inadequately defined responsibility for decision making were evident in Indonesia, where delayed responses to the lack of vehicles and inadequate housing reduced operational efficiency on two projects.

9.89 **CIDA should ensure that roles and responsibilities for program delivery are clearly established, communicated and monitored.**

> *Agency response: Agreed. CIDA will revise and up-date present documents to clarify the roles and responsibilities for program delivery - to take into account, in particular, the recent establishment of the Professional Services Branch and the Operations Services Branch, the increased use of administrative units in the field, and the move towards the use of a single executing agency for each project.*

Case Study: Lycée professionnel hôtelier d'Abidjan

Issue: Reporting and Accountability Relationships

In 1974, CIDA agreed to participate with the Ivory Coast in establishing the "Lycée professionnel hôtelier d'Abidjan (LPHA)". This project was to support the Ivory Coast in developing and improving the tourist industry and to improve the training infrastructure for hotel workers. CIDA decided to participate in the project because the Ivory Coast

considered it a priority and Canadian expertise was available. The project concerning LPHA did not fit the Agency's sectoral priorities for the Ivory Coast. It included:

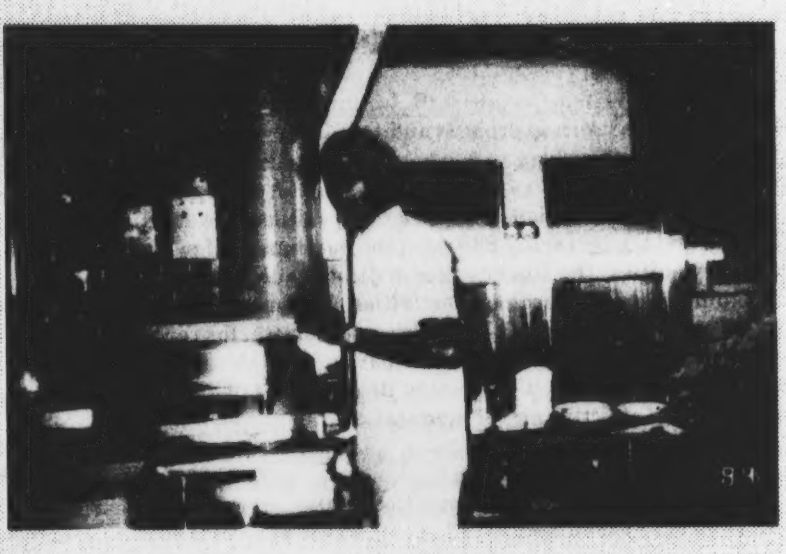
- constructing a school;
- purchasing, delivering and installing Canadian material and equipment; and
- providing technical assistance in instruction and pedagogy.

Originally valued at $3.5 million, it was to be completed within a six-year period, 1974-80. As the result of three budgetary increases, the project to date has cost $8 million. It is scheduled for completion by 31 December 1985.

CIDA contracted with three Canadian firms for project implementation. CIDA did not appoint an on-site project manager to lead and co-ordinate the activities of the firms and make administrative decisions as they arose. The project leader at CIDA Headquarters had the responsibility to co-ordinate and control the project. The project leader was supported by a Resources Branch sectoral expert and some consultants. However, there were at least nine different project leaders in the period 1974 to 1984 and, during the crucial period from 1977 to 1980, there were five different project leaders. At the project site, only the technical assistance component had continuity; the other participants were on the site depending on project needs or at CIDA's request. Consequently, CIDA reacted slowly to consultant recommendations or was only informed after the problems were resolved. As well, it was difficult for CIDA to determine the specific responsibilities of each participant as the project unfolded.

In March 1977, CIDA agreed that the Ivory Coast should finance and manage the construction of the school with assistance from a Canadian adviser. Among other things, the Canadian adviser was to ensure that the plans and drawings prepared by a Canadian architect were followed. During the following year, a consultant on an evaluation mission noted important delays in the start of work and, in March 1978, the Embassy stated that the work already completed did not conform to the Canadian designs: without the knowledge of CIDA, the site for the school had been changed. A part of the building constructed by the Ivory Coast needed to be demolished at that country's expense, and work was suspended until March 1979. In January 1979, CIDA re-hired the Canadian architect in order to be sure that the construction followed the plans and drawings. The construction component, originally estimated to be complete in November 1978, was completed in October 1980 with additional costs of more than $400,000.

Since 1980, the school administration has complained of malfunctioning Canadian equipment and poor electrical systems. There were several causes for these problems, ranging from inappropriate design through non-conformance with specifications for packaging, and inappropriate storage to poor initial installation. Design and storage problems were a result of decisions by Ivory Coast to change sites and pavilion configurations. Original electrical installations were completed by an Ivorian contractor. Because of the complexity of the situation, CIDA was unable to determine the parties responsible, with the exception of one. In that case, CIDA withheld a payment of $30,000. CIDA anticipated completing this project in the summer of 1984. We noted that the firm responsible for the pedagogical aspects of the project was able to ensure continuity on these aspects.



Some of the Canadian equipment in the Lycée professionnel hôtelier in Abidjan, Ivory Coast, has not functioned properly since its installation in 1980.

9.90 **Contracting for goods.** An important part of all projects is the acquisition of goods. CIDA must contract for goods through agents. In planning a project, CIDA agrees with the recipient country on the division of responsibility for procurement and for procurement agents to be used. Regardless of the arrangement and the procurement agent used, CIDA is responsible for ensuring proper procurement planning and for monitoring adherence to Treasury Board terms and conditions.

9.91 The Agency has not thoroughly assessed its authority for procurement and communicated the options to its planning officers. Project teams undertook procurement activities appropriate to their understanding of their responsibilities; however, they had an inadequate knowledge of these responsibilities. There is confusion over the use of procurement agents by the Agency. Some officers erroneously believe that procurement has to be directed through Supply and Services Canada. In planning procurement, the relative merits of using Supply and Services or having the recipient country contract with another procurement agent should be examined by CIDA. The result of inadequate knowledge is that inappropriate mechanisms are often used.

9.92 Project leaders perceived their options as follows:

- take a chance on everything working as planned;
- over-supply spares at the outset (5-year supply instead of 1);
- over-supply basic equipment (2 items instead of 1); or
- risk equipment breakdown and out-of-service situations for unacceptably long periods of time.

We observed all four situations in projects audited.

9.93 CIDA is in a position of considerable influence when making purchases both because of its size and the recurring nature of the purchases. However, with the exception of food aid and commodities, the Agency does not have adequate information on the nature, volume and timing of its procurement activities. Without a good data base, procurement officers cannot make recommendations, where appropriate, for realizing economies of scale, nor can they adequately plan for their participation in bilateral projects. The Procurement Division cannot assess whether it is meeting its objectives of ensuring that procurement by the Agency is efficient, effective and economical.

9.94 In May 1982, the President's Committee approved a clear mandate for the Procurement Division as well as a detailed statement of its role and responsibilities. This decision was never clearly communicated to Resources and Program Branches, nor have bilateral project staff been given complete, clear and detailed information on the procurement process.

9.95 Procurement experts were not providing the level of service needed for proper procurement planning and monitoring. The Procurement Division did not know how many bilateral projects were in the planning phase or how many had a procurement component.

9.96 The mandate of Procurement Division includes monitoring procurement aspects of bilateral projects with major procurement components. It estimated that 240 projects had significant procurement components. Procurement Division was monitoring only 40 of these projects. Other projects are planned and monitored by the bilateral branches, in many cases through procurement agents and implementing agents. Procurement Division did not know whether all projects having a significant procurement component were being monitored or whether procurement monitoring was being done adequately.

9.97 **CIDA should strengthen the procurement planning and monitoring services provided by the Procurement Division. CIDA should improve its communication of Agency procurement policies, procedures and guidelines to the project teams and consultants involved in procuring goods for the Agency.**

Agency response:

Procurement Planning and Monitoring
Agreed. The Agency is in the process of a complete review of the adequacy of its procurement planning and monitoring arrangements through both the Procurement Division and the geographic branches, and any shortcomings will be rectified as a matter of corporate priority.

Communication of Procurement Policies, Procedures and Guidelines
Agreed. CIDA's reorganization of July 1984 placed Procurement Division within a branch with the mandate to develop and communicate policies, procedures and guidelines for all operational functions in support of CIDA's geographic programs. The Agency will put high priority on increasing the level and quality of internal expertise to project teams by disseminating a full range of policies, procedures, and guidelines related to procurement in the coming six months.

9.98 **Monitoring implementation.** Adequate procedures exist for providing guidance for financial disbursements and for establishing contract terms and conditions and roles and responsibilities of all contracting parties. However, these procedures are not consistently followed. A continuing problem exists in the relationship between bilateral desks and Resources Branch. Resources Branch technical experts were unable to provide the required level of service. The project team leaders were not always consulting with and providing technical reports to the technical experts. The impact of this problem is felt throughout the project management process, particularly in the lack of an adequate assessment of progress reports submitted by contractors.

9.99 A second problem is the lack of financial information that compares, on a project basis, the expenditures to plans by specific activities within the project. Without a clear financial report, it is difficult to determine the cause of variances from plan and take corrective action. This problem was being addressed by the Agency in its Long Range System Plan.

9.100 Guidelines on Post project monitoring responsibilities have not been enforced. There were no follow-up procedures for completed projects. Throughout bilateral projects, the degree of emphasis placed on project monitoring varied considerably. In many cases, field officers did not know what was expected of them. As well, heads of section at the Post did not know what expectations had been established concerning field officers, site visits and other project monitoring duties. Factors such as degree of difficulty in travel to the project site and other Post reporting duties play a significant role in determining the frequency of site visits. For example, one officer had not been to a project site for eight months. The general lack of priority of site visits was accompanied by an equally low level of project knowledge. This has implications for field officers in assessing project management problems and reporting effectively to Headquarters. We concluded that monitoring activities were ad hoc and insufficiently structured to ensure efficient project delivery.

9.101 CIDA has not systematically reviewed completed projects to determine what has occurred since completion and to determine what lessons may be learned. Project files at the field level did not always contain the documents necessary for project monitoring activities. Project binders that were in Headquarters were not always available in the field. Key documents, such as copies of contracts, were missing.

9.102 CIDA should systematically monitor ongoing projects and review completed projects to determine what has transpired so that experience gained can be used to improve the planning and execution of future projects.

> *Agency response: Agreed. As indicated under recommendation 9.72, the addition of more technical personnel in the field will help strengthen CIDA's capacity to monitor ongoing projects.*
>
> *CIDA already possesses an informal "memory" of experience acquired from program monitoring and evaluation which is applied by the sectoral specialists in their capacity as project team members during the planning of new projects.*
>
> *At the formal level, the Agency has completed a review of all findings from project evaluations from 1980 to 1983 inclusive, and plans to continue such reviews annually.*
>
> *CIDA will soon have in place a computerized system for access to the experience gained from major projects completed between 1968 and the present.*

9.103 Monitoring recipient country obligations is weak. Financial and contractual obligations of the recipient country are not easily enforced without jeopardizing good will between Canada and the recipient country. In certain cases, the financial circumstances of the recipient country changed dramatically during the project. This led to a reduction of funds by the recipient country and to their inability to meet the agreement and project needs. During implementation, project team leaders and field representatives may become aware of recipient country failures to meet agreed terms. However, CIDA is reluctant to revise its original plans and usually elects to apply pressure on the recipient country. In some cases, the recipient country obligations include components directly affecting the working and living conditions of Canadians on projects. This has resulted in project implementors becoming demoralized and the project being compromised. An alternative would be to implement sooner appropriate strategies to ensure the continuity of projects. Such strategies could include increased funding or a reduction in the scope of the project.

9.104 CIDA should ensure that recipient country obligations are more closely monitored and appropriate responses developed.

> *Agency response: Agreed. CIDA has, quite recently, introduced in all bilateral projects a component of risk and contingency which provides, among other things, for any inability on the part of a host government to meet its obligations, in whole or in part.*

A policy paper on "recurrent costs" is also under preparation which will set the parameters within which CIDA officers will be able to judge when CIDA funds can be used as a substitute for obligations which may not be met by a host country.

Project teams will be reminded that host country obligations should be more closely monitored within the available administrative resources.

Evaluation

9.105 The quality of project evaluations and the system for planning and monitoring evaluation activities vary among the Bilateral Branches. It is not cost-effective to evaluate all bilateral projects. It is important, therefore, to develop an evaluation framework that would be used to select projects for evaluation. CIDA has not established such an evaluation framework.

9.106 CIDA should develop an evaluation framework for evaluating bilateral projects.

> *Agency response:* *Agreed. Guidelines for project officers will in future be included in an annual project evaluation call letter which will outline the criteria to be used during the following year for the selection of bilateral projects for evaluation.*

9.107 Although some satisfactory evaluations have been completed, the format and terms of reference were ambiguous. Evaluation planning did not always take place at the outset of a project, when goals and objectives were being established. While evaluators were not required to discuss the evaluation approach with the Evaluation Division, they usually did.

9.108 The use of evaluations varied among the Bilateral Branches. In one case, summary evaluations were circulated to project officers, and a catalogue of completed evaluations was maintained. In other cases, evaluations were not circulated, and no register was kept. In these latter cases, project officers could not learn from the experiences of others.

Case Study: Wheat Development in Zambia

Issue: Evaluation and Follow-up

In 1974, Canada was asked to participate in a wheat development project with Zambia. The feasibility studies called for progressive involvement from reasearch to production. CIDA conducted limited trials and proceeded to full production. The farms subsequently experienced crop failures and low yields (20 per cent of anticipated). Phase I of the project

was terminated prematurely; there was no project evaluation and no project termination report. The mistake of Phase I was to go into full-scale production without adequate testing of soil acidity, temperature, fertility or disease.

Phase II began in 1979 and included the same two components: one for production and one for research. The research component, however, was delayed by approximately two years. In 1980, 1,325 acres of wheat were planted. The yield was one-third of the amount predicted. The next year, the acreage was expanded to 2,325 acres; yields were one-half of the target.

An interim evaluation, aimed primarily at assessing the economic viability of growing wheat in Zambia, was carried out in 1981. It recommended immediate action on the research component and continuation of the production component of the project. However, the evaluation report did not address problems occurring in the production component of the Project. CIDA decided to reject the recommendation for further production and shut down wheat production in 1982. Since that time, only research and trial applications have been carried out.

CIDA has spent approximately $8 million and Zambia between $2 million and $4 million during the two phases of the project. The main weakness of Phase I -the failure to do adequate research before going to full production - was repeated again in Phase II. No project evaluation was done at the end of Phase II. CIDA initiated a Phase III in 1984 to undertake research before starting large production facilities.

The failure to establish an appropriate evaluation framework, evaluate a project with serious problems and conduct proper project termination activities contributed to the repetition of mistakes throughout the project.

Multilateral Programs Branch

9.109 The Multilateral Programs Branch consists of four operating units: Food Aid Evaluation and Co-ordination Centre; International Financial Institutions; United Nations Programmes; and International Humanitarian Assistance. Collectively, Multilateral Programs accounted for approximately $740.1 million in the 1982-83 fiscal year, or about 44 per cent of all Official Development Assistance (ODA). The total for 1983-84 was $830.7 million or about 45.3 per cent of all ODA.

Multilateral Programs Branch
(in millions of dollars)

	Food Aid	International Financial Institutions	United Nations Programmes	International Humanitarian Assistance
1982-83	$ 273.1	$ 318.0	$ 114.5	$ 34.5
1983-84	$ 321.6	$ 349.1	$ 123.8	$ 36.2

9.110 Our audit consisted of a follow-up of Branch activities in relation to previous audit observations in our 1979 Report, in addition to a review of the Food Aid Program. We reviewed programs valued at approximately $724.7 million or 87 per cent of the Multilateral Branch budget for 1983-84.

9.111 Our review assessed:

- International Financial Institutions in relation to a 1984 evaluation of the program and an assessment of an outstanding policy consideration;
- CIDA participation in the United Nations Development Program; and
- the Food Aid Program, discussed in a previous section of this chapter.

9.112 Our findings indicate that CIDA has devoted considerable attention to determining benefits derived from financial participation in various International Financial Institutions (IFI). These institutions include the World Bank Group, Asian Development Bank, Inter-American Development Bank, African Development Bank and Fund, and the Caribbean Development Bank. CIDA's review indicates that all IFIs sufficiently reflect CIDA's objectives in Third World development. Although there are significant shortcomings in terms of quantifying IFI results, it is not clear that superior reporting techniques will be available in the near future. The differences in IFI lending policies are appropriate to their areas of geographical concentration. In terms of procurement from Canadian business, no overt bias for or against Canada was evident in relation to other donor countries.

9.113 Overall, CIDA is reasonably aware of the operations to which Canada has contributed financially. CIDA's review of IFIs is ongoing and has contributed to a satisfactory level of accountability with regard to Canadian international financial commitments. Canadian representation in the World Bank Group, as well as budgetary responsibility, rests with the Minister of Finance.

9.114 Our review of CIDA participation in the United Nations Development Program (UNDP) revealed high profile Canadian leadership in the management of the Program. This leadership role is commensurate with the level of contribution to the Program ($56 million in 1982-83 and $59 million in 1983-84).

9.115 Canada, through CIDA, maintains an influential position on the Governing Council of the UNDP and was President of the Council in 1982. CIDA has also influenced improvements in accountability relationships within the UNDP and has been supportive in the clarification of program evaluation activities within the Program. These activities are in accordance with CIDA's program responsibilities and constitute a satisfactory level of participation in light of program expenditures.

9.116 In a management context, Multilateral Programs Branch has completed a Management Systems Manual which is now in use. Also, the Branch has continued to expand its use of institutional appraisals for all agencies to which CIDA makes financial contributions. We reviewed a sample of these appraisals and found a consistent format and methodological approach. This approach adequately assesses institutional performance in light of CIDA objectives.

Special Programs

9.117 The goal of the Special Programs Branch is to stimulate and support the participation of non-governmental organizations (NGO), educational institutions, professional associations, co-operatives, the trade union movement and the private sector in international development co-operation.

9.118 The Branch provides funds for the development activities of approximately 300 Canadian and international NGOs and several hundred private companies and organizations. CIDA annually supports approximately 4,000 programs and projects in over 100 countries. Special Programs Branch has grown dramatically in the past five years from $63.9 million disbursed in 1979-80 to $190.6 million in 1983-84. In the same period, person-years have risen from 59 to 89, and the number of divisions has increased from 3 to 7.

9.119 NGO projects funded by CIDA are concentrated in grassroots activities not easily administered through bilateral and multilateral channels. These activities involve the active participation of people in recipient countries, strengthening local institutions and indigenous efforts, and tapping into local resources.

9.120 Special Programs Branch receives requests for funds from NGOs and private organizations. These requests are evaluated and funded according to Treasury Board terms and conditions. Because of the amount of funds involved, CIDA exercises considerable influence in the voluntary and private sector and generally does not have any difficulty obtaining the information it requests.

9.121 Special Programs Branch has funded many projects that have achieved international acclaim. CIDA funding permits NGOs and international non-governmental organizations to adopt innovative approaches and encourage Canadians to participate in many small development projects.

9.122 Special Programs Branch reviews of requests for funds are intended to determine the capability and commitment of the funded organization to meet the objectives of the projects it is undertaking and to ensure that projects are within acceptable areas of activity for CIDA. Special Programs Branch needs to monitor the progress of approved projects to assess the degree of project achievement and the need for additional funding. The Agency policy of non-interference toward the development initiatives of NGOs and private companies has emphasized the need for trust and confidence that has prevailed.

Planning and Approval

9.123 We noted two deficiencies in the planning for program delivery: the lack of standardized planning systems; and the insufficiency of documentation for deciding on whether to fund a project. We found the information on file did not always describe fully the capabilities of the NGO or private sector organization to deliver the project. While selection criteria for assessing or evaluating project requests or identifying key factors exist, they are not consistently followed. Some approved projects did not have key information on previous projects undertaken in that sector by that agent.

9.124 CIDA should strengthen approval procedures that ensure appropriate criteria have been applied and adequate information has been obtained for Special Programs Branch Projects.

> Agency response: *Agreed. The Branch is in the process of improving its project approval process. Among other things, the revisions will highlight the information required to allow managers to approve projects and the general criteria against which projects are selected.*

Monitoring and Evaluation

9.125 Monitoring and evaluation of funded projects was sporadic. One of the terms of the project agreement is that the funded organization provide CIDA with periodic reports. We noted instances where the reports were not submitted or were incomplete. No follow-up action was taken by CIDA. In other instances, reports were submitted, but no critical analysis of the reports was done. Furthermore, the Branch has not defined criteria for monitoring projects. As a result, the Branch cannot provide information on successful projects.

9.126 CIDA should improve procedures for monitoring projects and conducting project evaluations of Special Programs in order to enhance the selection of future projects and identify active projects that should be terminated.

> Agency response: *Agreed. In May this year, an evaluation policy for the Special Programs Branch was approved whereby evaluations will be programmed on an annual basis and will use standardized terms of reference and approaches. In this context evaluations will include project evaluations, program evaluations, and organizational assessments. The annual evaluation plans will be structured so that within three years the major organizations receiving in total 70 per cent of the Branch's funding will have been covered by organizational assessments. Increased project monitoring in the field is also planned.*

9.127 Deficiencies in the Special Programs Branch's information base made it difficult to communicate information to other groups within CIDA. Such communication would support the planning efforts of those groups. Special Programs Branch distributed to Posts information on projects funded by the Branch. However, this information was not used by field officers. Field officers are unaware of many projects operating in the recipient country. This creates a potential problem of co-ordination and duplication with Mission Administered Funds, which support similar projects. Without detailed project information on Special Programs, Posts cannot provide appropriate feedback on project activities.

9.128 Field officers should ensure that they are made aware of information communicated to the Posts by Special Programs Branch.

> Agency response: *Agreed. CIDA will continue to improve the information communicated to the Posts which is related to Special Programs Branch activities and field officers will be reminded to make appropriate arrangements to obtain and communicate such information.*

Support Functions

Payroll Costs Management

9.129 In our audit of payroll costs management, we examined the management of the personnel function, human resource planning, human resource information systems and training and development. In addition to a review of documents, we interviewed line managers and personnel staff.

9.130 **Management of the personnel function.** In the past few years, CIDA has been the object of a number of human resource management studies, including a 1979 Auditor General comprehensive audit which took payroll costs management into account, a 1983 Public Service Commission Staffing Audit, the 1980 Mobility Study for Bilateral Branch, and the 1984 Framework for Human Resource Planning. Prompt and efficient action has not been taken to deal with the studies' recommendations that should be a priority to the Agency. There is no Agency management procedure to ensure adequate follow-up of these studies.

9.131 For example, the Mobility Study identified a serious mobility problem that could be partially resolved by "underfilling" positions. Implementation of the underfill program began in 1984, two years after the recommendation was made. The Mobility Study recommended career planning within the Agency. Most managers and employees within CIDA agreed with this recommendation, especially when the Foreign Service category was initiated. However, no clear management position was taken.

9.132 Central agency and internal CIDA recommendations should be considered promptly to bring about appropriate modification of CIDA's personnel policies and systems.

> Agency response: *Such modifications have been planned and implemented within reasonable timeframes in most cases.*

> *A complete career planning process has not yet been developed within the Agency, initially because of Foreign Service consolidation and the 1982 Agency reorganization, and more recently because of the FS-3 conversion exercise and our current restructuring. However, a number of key contributing mechanisms have been introduced over the past few years.*

9.133 CIDA has not fully assessed the human resource implications of several major organizational changes. Agency documents identify human resources required at a macro-level. However, the more specific human resource planning needed to implement the changes was not adequate. For example, the capacity of the Agency to deal with the increased workload and complexity brought on by the country focus approach was not adequately assessed in relation to the present number of staff. As well, consolidation of the Foreign Service in 1982 has had operational and career implications that are still unresolved. The implementation of the Four A structure, a major organizational change that resulted in the Bilateral Branch being split into four area Branches, left many key positions vacant for over a year. Although the Agency attempted to fill these positions quickly, difficulties were encountered in the staffing process and in foreign service consolidation that were beyond the control of the Agency.

9.134 **The Agency should ensure that the human resource implications of organizational changes are fully assessed in terms of operational requirements.**

> Agency response: *Agreed in principle: past Treasury Board submissions, and other policy documents have, whenever possible, assessed the human resource implications of organizational change in terms of operational requirements.*

9.135 **Human resource planning.** The number, type, level and location of employees needed to carry out the Agency's operational objectives and/or work plans have not been clearly or adequately identified. The current status is partly due to the complexity and changing nature of CIDA's environment and partly due to the Agency's difficulty in developing meaningful operational plans. For example:

- The Agency has not clearly defined the mix of skills required to deal with project planning.
- The Agency has not adequately identified the most appropriate location for, or the number or level of program managers and technical experts positions required within the Special Programs, Resources and Four A Branches to ensure maximum efficiency in managing and administering aid projects.

9.136 Because some human resource needs have not been specifically identified and others have not been satisfied, important functions within the context of project management have been abandoned or deferred. These include functions such as maintaining adequate contact with NGOs, continuing supervision of consultants, and monitoring projects in the field. These functions affect CIDA's credibility and the quality of project implementation.

9.137 The Agency should develop a human resource planning system, linked to operational plans, including the human resources needed to perform key functions.

> *Agency response: Agreed. The introduction of the Multi-Year Human Resource Plan (MYHRP) in 1985-86, the implementation of the 1984 Framework for Human Resource Planning and the current enrichments to the human resource data base will improve the Agency's capabilities in this area.*

9.138 **Human resource information system.** CIDA's human resource information system has been designed to meet personnel specialist information needs, not the needs of line management. The information systems were established in response to central agency requirements rather than CIDA management requirements.

9.139 Many line managers are unclear as to what information they would need on human resources. Some have already started developing their own programs to control their branch person-year utilization. Line managers have not been involved in the development of Agency personnel information systems, and user requirements have not been clarified in sufficient detail to permit implementation of a cohesive system. The development of a human resource information system is part of the Agency's Long Range System Plan.

9.140 The Agency should re-examine line managers' human resource management information needs and, if necessary, develop information systems to meet these needs.

> *Agency response: Agreed. The Agency will include this requirement in its assessment of need and evaluation of priority for the next phase of its informatics activities.*

9.141 **Training and development.** Training needs have been identified for some key occupational groups and are systematically reviewed with line managers. Priorities are established by senior Agency managers and resources allocated accordingly.

9.142 The amount of training within the Agency has increased substantially over the past few years. Training costs have been adequately controlled, and the training activities have been appropriately evaluated.

Financial Management

9.143 Since our 1979 audit, the Agency has improved its control over commitments and disbursements. CIDA's policies and procedures have been revised to ensure that appropriate procedures are communicated to project officers. Internal Audit and the Audit Services Bureau of Supply and Services Canada, under contract to CIDA, perform financial audits on projects to ensure compliance with policies and procedures. In our audit of bilateral projects, we found no instances where commitment control and disbursements control procedures were violated.

9.144 In 1979, we reported that the financial reporting system was "inadequate because reports were untimely, unreliable and did not facilitate variance analysis." At that time, CIDA was developing the Long Range System Plan. We endorsed CIDA's action and recommended that the Agency give top priority to completing and implementing this Plan. In anticipation of the Plan, the Agency undertook temporary measures to produce essential financial information. We found that the accounting information generated was adequate to meet the design purpose. However, we did not perform a complete systems audit because the financial reporting system was temporary.

9.145 In our current audit, we found the main parts of the Long Range System Plan were close to producing Financial Systems Reports. The first reports were expected on 1 April 1984, and the Bilateral Project Reports were scheduled for 1 October 1984. This is two years behind the schedule reported in 1979.

9.146 One part of the Long Range System Plan is the Aid Information System (AIDIS). An interim system, AIDIS I, was put in place to address some basic needs. AIDIS II replaces AIDIS I. Our review of sample reports from AIDIS II indicated that they should satisfy the needs for financial information. However, because no reports had been produced using current data, we were unable to determine whether AIDIS II was performing satisfactorily.

Internal Audit

9.147 In 1981, the Agency, through its Audit and Evaluation Committee, approved an "audit concept paper" which was designed to serve as a guide to the continued development and implementation of comprehensive auditing in CIDA. In May 1982, the President approved an internal audit policy which clearly outlined the mandate, role and scope of Internal Audit. The policy also highlighted the broad objectives of the Audit and Evaluation Committee and the basic responsibilities of auditors and auditee.

9.148 Major improvements have been made in planning and scheduling audit assignments, with the production of the five-year and annual work plans.

9.149 Our examination of the five-year, long-term integrated audit program indicated that the Internal Audit Division has identified all Agency responsibility centres, systems, and major functions for potential audits. The Division has established criteria to rank potential audit areas and has determined appropriate audit objectives for each area selected for audit. In our audit, we made use of Internal Audit's work to reduce the extent of testing in some areas.

9.150 Internal Audit issues reports or management letters at the conclusion of each audit assignment. We noted that the time from the date the first draft report was completed until review of the final report by the Audit and Evaluation Committee ranged up to 17 months, with an average delay of 7 months. Some of the delay results from the audited groups reviewing draft reports and preparing responses. However, lengthy delays in reporting audit results to senior management reduce the usefulness of the audit reports and the urgency for the auditee to take corrective action. Also, the weaknesses identified cannot be put into context with other Agency initiatives. Providing a preliminary draft of audit findings to the Audit and Evaluation Committee would provide senior management with current audit findings.

9.151 Internal Audit should present significant audit findings to the Audit and Evaluation Committee as soon as possible after completing the field work.

> *Agency response: Agreed. The current practice is to refer all significant audit finding to Branch management as soon as confirmed. These are normally discussed at senior management level, sometimes with the President or at the President's Committee or more frequently at meetings of the Area Management Group which consists of senior operational managers at the Vice-President and Director General level. This practice will be formalized to ensure that all significant findings are in fact referred to senior management as soon as they are confirmed.*

Corporate Memory and Program Evaluation

9.152 Corporate memory. The systematic collection of data related to the Agency's environment, strategies and operational tasks is the corporate memory. It is enhanced by job continuity, adequate documentation and information retrieval, systematic treatment of studies and reviews, and good program evaluation. As discussed earlier, our audit revealed high staff turnover, poorly used information systems and a need for improved documentation. Project officers placed a low priority on the importance of documentation and filing. CIDA is taking action to improve these areas.

9.153 The Agency has not developed adequate mechanisms to document, store and use past experiences. Studies conducted by CIDA and external groups identify problems and opportunities within the Agency. However, in some cases, there is no formal mechanism to ensure that the resulting recommendations are considered in decision making. In some instances, no corrective action has been taken, and officers have been unaware of completed studies.

9.154 We examined decisions of the President's Committee dealing with operational issues. No follow-up procedures existed to determine whether the decisions were carried out. In some cases, decisions were not communicated or, if they were, action was not taken.

9.155 The Agency should improve procedures to ensure that findings from studies, evaluations and management reviews are considered and should develop follow-up procedures to ensure that approved recommendations are implemented.

> Agency response: *Agreed. CIDA will review current procedures for considering the findings of studies, evaluations, and management reviews.*

9.156 **Program evaluation.** CIDA has developed a number of evaluation mechanisms to assess the results of its projects and programs. A major concern is that evaluation activity has not been occurring in an integrated and co-ordinated evaluation system. Different levels of evaluation – project, program (critical), and corporate – serve different objectives and clients.

9.157 Project-level evaluations are undertaken at the discretion of the project team leader. In its planning phase, each project should include an evaluation framework which the team leader puts into operation as circumstances dictate. These evaluation frameworks are intended to provide the corporate project memory. The Evaluation Division has conducted a special study of project evaluations and has initiated a procedure for annual reviews of project evaluations.

9.158 Critical evaluations are being developed by the program managers as part of the Country Program Review document. They will ensure systematic and cyclical evaluations of the bilateral Country Programs. These critical evaluations range widely with respect to level of effort and quality, although there is an improvement in the quality of more recent critical evaluations.

9.159 To plan corporate evaluations, it is essential that the Agency have a component structure that defines the "components" or "programs" to be evaluated at the corporate level. A component structure was approved by the President's Committee in September 1981. CIDA management has judged it unsatisfactory with respect to bilateral programs. The Evaluation Division is currently revising the component structure for bilateral programs.

9.160 The Evaluation Division has taken a number of initiatives to address the issue of corporate level evaluation; however, no evaluation studies of this type have been completed. Two corporate level evaluation studies were in progress at the time of our audit.

9.161 The requirement for corporate evaluations was added to other evaluation activities in the Agency. Procedures to co-ordinate evaluation activity in the Agency and to ensure the quality of all levels of evaluations are just now being established.

9.162 The Agency should implement the plan of operation that allows the Evaluation Division to carry out its responsibilities with respect to:

- **co-ordination of evaluation activity in the Agency;**
- **quality control for project and program (critical) evaluation; and**
- **corporate-level evaluation.**

Agency response: Agreed. The Agency has started to implement its plan of operation and within a year the co-ordination, quality control and corporate evaluation plan should be under way.

NATIONAL ENERGY BOARD

NATIONAL ENERGY BOARD

Table of Contents

	Paragraph	Page
Overview	10.1	10-1
Audit Scope	10.4	10-1
Observations and Recommendations	10.5	10-2
Analytic Support for Board Decision Making	10.6	10-2
Encouraging Economy and Efficiency in Regulated Companies	10.12	10-4
Monitoring and Control	10.36	10-10
Internal Management	10.44	10-12
National Energy Board's Response		10-13

10

NATIONAL ENERGY BOARD

Overview

10.1 The National Energy Board was established in 1959. Its primary purpose then was "to ensure that present and future Canadian requirements for energy are taken fully and systematically into account in granting licences for exporting energy." Under its current mandate, the Board controls the import and export of certain kinds of energy, regulates the construction and operation of specified energy projects and acts as an administrator of two programs on behalf of the federal government. In addition, it serves as a source of advice to the Minister of Energy, Mines and Resources on specific policy questions and periodically undertakes studies of various energy issues both on its own initiative and at the request of the Minister.

10.2 The National Energy Board consists of 11 Order-in-Council appointees and about 460 public servants. It is a court of record with full and exclusive jurisdiction to enquire into, hear and determine any matters that appear to the Board to be in its area of jurisdiction. The Board regulates 39 oil or gas transmission pipelines and about 100 international electrical power connections but has no regulatory authority over coal or nuclear power. In its domain, the Board's regulatory authority is ultimately based on, and limited to, aspects of energy falling within the authority of the federal parliament - that is, interprovincial and international trade. In its regulatory role, the Board functions as a quasi-judicial tribunal. Some of its decisions have the force of law; for others, the concurrence of the Governor in Council is required. Under certain circumstances, its decisions may be appealed to the Federal Court of Appeal.

10.3 The value of gross energy exports exceeded $11 billion in 1983; the value of regulated imports and interprovincial trade was over $20 billion. The value of pipeline tolls regulated in 1983 was about $1.6 billion.

Audit Scope

10.4 Each year, we undertake and report on an audit of the accounts of the National Energy Board as an integral part of our audit of the Public Accounts of Canada. This year we also examined the procedures leading to and supporting the Board's regulatory decisions, particularly the management controls over the analysis supporting these decisions and the technical completeness of the analysis. The audit team included people knowledgeable in such fields as forecasting, reserves estimation, pipeline construction and economics. We examined the procedures used by the Board to monitor compliance with its decisions and determine the impacts of the decisions, as well as its administration of the Export Charge and Transportation Fuel Compensation Recovery Charge programs. We also examined the financial management and other controls internal to the Board's operations.

Observations and Recommendations

10.5 Our observations and recommendations are presented under four headings: analytic support for the Board decision making; procedures to encourage economy and efficiency in regulated pipeline companies; monitoring and control, and internal management.

Analytic Support for Board Decision Making

10.6 **Background.** The Board regulates and advises on many aspects of the Canadian energy transmission industry including: exports; facilities construction and operation; tolls, tariffs and traffic; allocation of oil supplies in the east; and interprovincial gas movement. In general terms, the Board is enjoined by the NEB Act to regulate in the public interest. It has extensive discretion in doing this; it generally may take into account any matters that to it "appear to be relevant". In some regulatory situations only general guidance is provided in the Act; for others there is a list of factors that should, as a minimum, be considered. The general guidance is provided by phrases such as public convenience and necessity, to promote safety, just and reasonable, no unjust discrimination, necessary or desirable in the public interest, no undue burden, and equitable distribution.

10.7 The major examples of specific guidance are section 44 on construction of facilities and section 83 on export licensing. Section 44 states the Board may have regard for such things as:

(a) the availability of oil or gas to the pipeline, or power to the international power line, as the case may be;

(b) the existence of markets, actual or potential;

(c) the economic feasibility of the pipeline or international power line;

(d) the financial responsibility and financial structure of the applicant, the methods of financing the line and the extent to which Canadians will have an opportunity of participating in the financing, engineering and construction of the line; and

(e) any public interest that in the Board's opinion may be affected by the granting or the refusing of the application.

Section 83 on export licensing states that the Board shall

(a) satisfy itself that the quantity of oil, gas or power to be exported does not exceed the surplus remaining after due allowance has been made for the reasonably foreseeable requirements for use in Canada having regard, in the case of an application to export oil or gas, to the trends in the discovery of oil or gas in Canada;

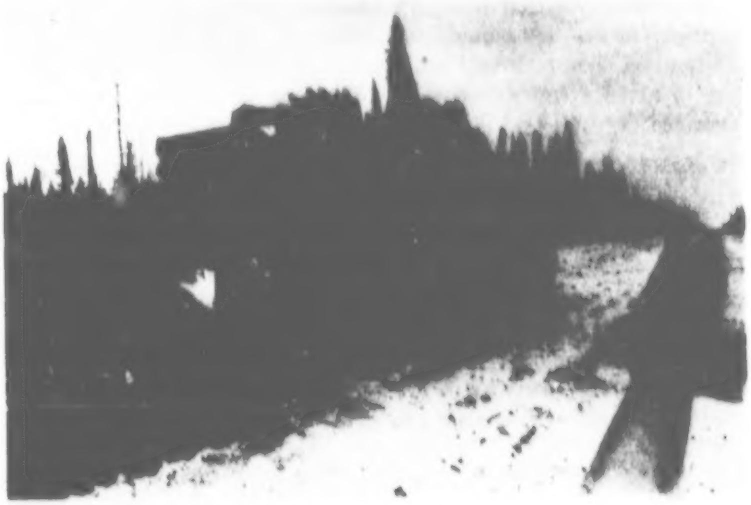
(b) satisfy itself that the price to be charged by an applicant for power exported by him is just and reasonable in relation to the public interest; and

(c) where oil or gas is to be exported and subsequently imported or where oil or gas is to be imported, have regard to the equitable distribution of oil or gas, as the case may be, in Canada.

10.8 The quotations indicate clearly the breadth and importance of the analytic support to the Board's decision making.

10.9 **Observations.** We audited most of the analytic support functions and relied on an internal audit of the analytic support for the toll administration process. We found no significant weaknesses in the many support functions we examined and found that they were generally well controlled.

10.10 For example, we found the long-term forecasting of energy supply and demand and the short-term forecasting of oil supply and demand to be technically complete and their preparation well controlled. For reserves estimation and assessment of the deliverability of natural gas and of the productive capacity of oil, we found good management controls and appropriate protection against bias in the results. Applications to construct facilities are reviewed for safety, cost, Canadian content and environmental and socio-economic impact. All these reviews are well controlled and technically complete. The analysis of applications for exporting oil, gas and electricity are suitable for determining "just and reasonable" pricing, and the related management controls are appropriate.



A ditch digger in operation on the Norman Wells-Zama oil pipeline. Remedial measures for adverse environmental effects are agreed on before construction starts.

10.11 There were minor weaknesses; for example, one major decision factor in approving new energy exports is an estimation of the net benefits to Canada resulting from exports. We believe the Board should have procedures for systematically reviewing the validity of previous net benefit estimates using current data. This would be an indicator of the effectiveness of using the net benefits criterion in the decision-making process for exports. Such a review could also serve as a basis for determining whether methods of calculating net benefits should be modified. It might also lead to the conclusion that such analysis should not be used, given the effect of uncontrollable external factors.

Encouraging Economy and Efficiency in Regulated Companies

10.12 **Background.** In an NEB information guide to pipeline companies, the objective of the Board's toll regulation is set out as follows:

> To ensure that the (regulated activities) are provided on a continuing basis, without unjust discrimination and in a cost-efficient manner approaching the costs that would prevail in a competitive market, recognizing that other factors such as government policies and competition from other energy forms may impact on regulation.

The following condition is imposed on the pipeline companies:

> The Board believes that there is an implied obligation on the pipeline companies to demonstrate to the Board and interested parties in toll hearings that they are conducting their business as if they were subject to the discipline of the market place.

10.13 In general terms, tolls are set for each transmission company so that it may recover its costs of service and earn up to an allowed rate of return on the rate base portion of its invested capital. Tolls have been regulated on this basis for many years. It is conceptually simple, is largely based on objectively determined data, and can ensure adequate profit to attract the investments required to provide necessary oil or gas transmission services.

10.14 Offsetting these advantages are some disadvantages. It is generally accepted that rate-base regulation creates a natural incentive for pipeline operators to spend money on their rate base beyond that which would be optimum economically. Further, there are no strong and direct incentives for pipeline operators to control their operating costs, as these costs can be recovered dollar for dollar in the tolls. In Canada, this latter disadvantage is aggravated by the fact that oil and gas prices are fixed by decree. This eliminates restraints on cost increases that would normally be present in the marketplace because of the need to be competitive with alternative sources of energy.

10.15 **Audit expectations.** In the absence of natural market incentives for cost efficient construction and operation of transmission companies, we would expect the Board to institute substitute controls and checks that would have a compensating effect. Over the years, the Board has instituted several controls of this kind and is currently implementing some and studying others. Nevertheless, we believe the Board could increase its efforts to encourage economy and efficiency on the part of regulated pipelines.

10.16 We recognize that this will not be a simple task for various reasons. First, the issues are very complex, and further substitute controls that are effective may not be easy to put into operation. Second, the NEB philosophy is that its task is to regulate, not manage, the transmission pipelines. Third, the Board is set up as a quasi-judicial tribunal. It therefore has a judicial role and decides on applications on the basis of evidence on the record of a particular hearing. Consequently, neither Board nor staff may act as advocates on particular issues and present their own evidence. Fourth, intervenors – parties contesting proposed toll charges at a public hearing – cannot always be effective substitute controls or checks since evidence about economy or efficiency is not made readily available to the public by the transmission companies, although it can be, and often is, sought by intervenors and the Board at public hearings.

10.17 **Some of the initiatives already taken by the Board.** The Board has for years recognized the importance of economy and efficiency of transmission. Public addresses given to the pipeline industry by the Chairman of the Board indicate this. It was specifically addressed in the first "Reasons for Decision" published on a rate hearing in 1971. This clearly stated that the pipeline companies should be "economic and efficient". A recent information bulletin states that the Board is to regulate so services are provided "... in a cost efficient manner, approaching the cost that would prevail in a competitive market".

10.18 In 1977, for example, the Board disallowed for toll determination purposes $17 million in costs for a $247 million construction project because it decided that these costs would not have been incurred had management been prudent. This practice of disallowance has continued. In 1979, the Board ordered a large transmission company to maintain operating cost budgets by cost centres, to facilitate review of the eligibility of these costs in ordering toll adjustments. The Board conducted a methodology hearing in 1984 to assess the appropriateness of this company's toll administration process. Also in 1979, the Board implemented a system of tolls for a major company to provide an incentive for controlling its capital expenditures during construction.

10.19 In the period 1980 to 1982, the Board staff conducted and published a study on pipeline construction costs from 1975 to 1985. This led the Minister of Energy, Mines and Resources to create an independent task force to study the issue. In response to the task force study, known as the Horte report, the Board and the industry are examining incentives that might be useful in construction cost control. For example, there is a proposal that the Board set up a construction monitoring system for all major projects to compare actual construction costs and progress of work against original plans. The Board used such a system on the Norman Wells-Zama pipeline. However, it should be noted that general economic conditions and labour agreements can have a greater influence on pipeline costs than can either the Board or the pipeline industry.

A welding crew at Seagram Creek, Northwest Territories.

10.20 The Board staff recently studied the possibility of requiring transmission companies to conduct comprehensive audits. We believe that, if such audits focused on particular aspects of regulated activities, they could provide the Board with valuable information for regulatory decision making. An NEB working group, active from 1979 to 1981, studied the issues of pipeline efficiency and productivity. The Board also co-sponsored a national conference on the difficult area of rate-levelling. This provided for a broad discussion of the problems of rate-of-return regulation in companies with expanding markets or a declining rate base. A similarly difficult area is the implementation of effective regulatory incentives for economic construction and efficient operation of pipelines. As part of its continuing efforts in this area, the Board conducted a meeting in September 1983 with industry representatives at which incentive schemes for cost control were discussed.

10.21 **Reporting on economy and efficiency by pipeline companies.** According to Board philosophy, companies have an obligation to demonstrate that they are operating economically and efficiently. We believe that they do not do this as well as they might. Reporting of efficiency measures by transmission companies is not now required, although we understand that it will be difficult for them to establish meaningful measures. Although satisfactory audit methods have been developed for some economy and efficiency issues, audits of economy and efficiency are not required. In our opinion, the Board could make the companies' obligation more real by establishing reporting and auditing requirements in this area, as do some regulatory agencies. The Board would then be in a better position to ensure that tolls are no higher than they need to be.

10.22 **New construction.** The Board makes two different kinds of decisions on pipelines. On the basis of estimated costs, markets, supply and so on, it first determines whether a proposed pipeline "is and will be required by the present and future public convenience and necessity". This is done under Part III of the Act. After construction it decides, on the basis of actual construction costs and estimates of operating costs, what just and reasonable tolls would be. It does this under Part IV of the Act.

10.23 In determining a large project's suitability under Part III, the Board is not given construction cost estimates based on detailed engineering designs because the exact installation conditions are not known. It examines the applicant's cost estimates for "reasonableness" using historical construction cost data. After the Board has decided that a proposed project is a public convenience and necessity, it will issue a certificate to this effect to the applicant. This certificate may require the applicant to submit satisfactory detailed cost estimates before starting construction. For small projects, cost estimates are based on engineering designs and often on tender documents. The Board reviews these applications in detail and rejects projects it believes are not justified.

10.24 In recent years, actual construction costs have occasionally exceeded the estimates. The Board's practice is to review actual costs and disallow, for toll determination purposes under Part IV, any construction costs that were demonstrably caused by imprudent management. It should be noted, however, that such decisions can be appealed to the Federal Court of Canada.

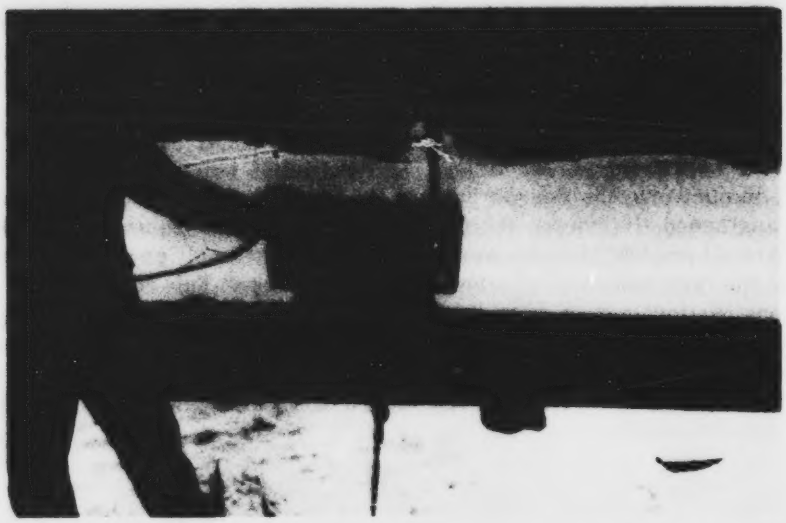
10.25 In our view, the Board's process for approving and costing new construction could be strengthened. If firm construction cost estimates were required before the start of construction on all projects, the onus could be placed more strongly on pipeline companies to demonstrate the reasonableness of proposed or actual costs. This requirement, combined with post-construction management audits and the proposed construction monitoring system, would put the Board in a stronger position to determine whether specific costs had been prudently incurred. These measures would also provide for an improved information base to support the Board in decisions to transfer the costs of poor management from the toll-payers to the shareholders.

10.26 When a major construction project is being considered, the Board performs an analysis that determines the least-cost combination of pipe diameters, pumping station locations and operating pressure as a function of forecast volumes to be transported. The Board is thus able to compare the applicant's overall design to the least-cost design.

10.27 **Current NEB audits.** The NEB staff conducts compliance audits of regulated companies to ensure that they are keeping their accounts in the prescribed way. For example, since several major transmission companies are conglomerates, the auditors check to ensure that overhead costs are allocated to non-regulated operations in a reasonable way and that depreciation allowances are calculated correctly. However, the NEB allocates only about 85 person-weeks a year to such audits of the 39 regulated companies. Trans-Canada Pipeline, whose annual cost of service is almost $1 billion, is audited in 23 person-weeks;

Westcoast Transmission, whose cost of service is $300 million, is audited in 19 person-weeks; and Interprovincial Pipeline, with costs of service of $117 million, is audited in 4 weeks. Some of the smaller of the 39 companies are not audited regularly. In our view, such resource levels limit many of these audits to a cursory examination.

10.28 The NEB auditors do not explicitly attempt to identify improper or imprudent expenditures. In the United States, the Federal Energy Regulatory Commission does look for such expenditures, and it finds them. In our review of files, we found no examples of questionable expenditures having been recorded by the compliance auditors. We believe the NEB audits could be designed to assess whether expenditures on items such as computers, accommodation and travel were being made with due regard for economy. Recently the Board audited parts of the inventories of two companies' maintenance supplies. As a consequence, some costs were disallowed. In general, our view is that broader scope audits would both assist the Board in determining just and reasonable tolls and contribute to challenging the economy and efficiency of the regulated companies.



A pipe weld X-ray machine. In Canada, every weld must be X-rayed, and NEB inspects to ensure this is done.

10.29 **Toll adjustments.** The Board has a system that monitors the financial performance of the transmission companies. Financial analysts on the Board's staff review periodic reports from companies on such things as their actual transported volumes, operating costs, revenues and rates of return and compare them with the same items previously authorized by the Board. As a consequence, the Board can adjust tolls downward if it considers it is in the public interest to do so.

10.30 On the other hand, a regulated pipeline company may apply for an upward toll adjustment. When a date is set for a toll hearing, it is advertised and an open invitation is issued to any parties who wish to intervene. The hearings thus provide a platform for arguments concerning the tolls to be set by the Board, except for the few routine cases each year where either no public hearings are held or there are no intervenors. The Board also periodically holds inquiries to collect opinions on how toll hearings should be conducted and what factors should be considered in establishing tolls.

10.31 Detailed analysis of applications for toll adjustments, which are often very complex, presents a challenge to the Board, the staff and intervenors. In its application, the company forecasts operating costs and volumes to be transported for a future period, and requests the revenues required to cover costs and provide a desired rate of return. The forecast of the volume to be transported is the most critical factor in determining the tolls. There is an incentive, therefore, for companies to make forecasts that are favourable to their case. There is also a strong incentive to obtain as high an allowable rate of return as possible by presenting the arguments and data analyses that support the contention that there is high risk. Intervenors are provided with copies of the application and all supporting documentation. They are expected to present alternative analyses in challenging cost and volume forecasts or the prudence or merit of claimed expenditures – either operating or rate base. However, they must obtain supporting information themselves because there is no general provision to put economy or efficiency audit findings, if there have been any, on the public record. Further, the NEB legislation does not provide resources or financial support for intervenors as does the Canadian Radio-television and Telecommunications Commission legislation.

10.32 The staff analyses applications and provides this analysis to the sitting Board members. If the staff believed that certain forecasts were invalid or that some expenditures had not been prudently made, it would not be able to present this information direct to the hearing. Because its role is to provide impartial analytical support to the hearing panel, it would suggest to Board counsel lines of questioning to be followed in cross-examination. The sitting panel members can also use this information in questioning the applicant or intervenors. In this way, information contrary to that presented by the applicant can be introduced and recorded so it may be considered in the Board's decision. This is a procedure that may be used when interventions are weak on an issue the Board considers relevant and of significant public interest.

10.33 We believe there are ways the Board could alter its procedures and practices for toll hearings that would provide for a stronger challenge of applications. For example, it might consider hiring independent experts to present evidence on a particular issue. It might also routinely call for audits or special studies of aspects of expenditures by regulated pipeline companies.

10.34 **Summary.** We acknowledge that the Board is charged with a difficult task in trying to protect the public interest while avoiding the pitfalls of heavy-handed regulation. It has taken many steps to protect this interest and we support it in further initiatives to encourage economic construction and efficient operation of pipelines. Such initiatives will take time and will require the co-operation of the industry; we recognize that they must therefore be part of a long-term program.

10.35 A long-term program should be undertaken to strengthen the Board's efforts to encourage economy and efficiency on the part of the regulated pipeline companies.

Monitoring and Control

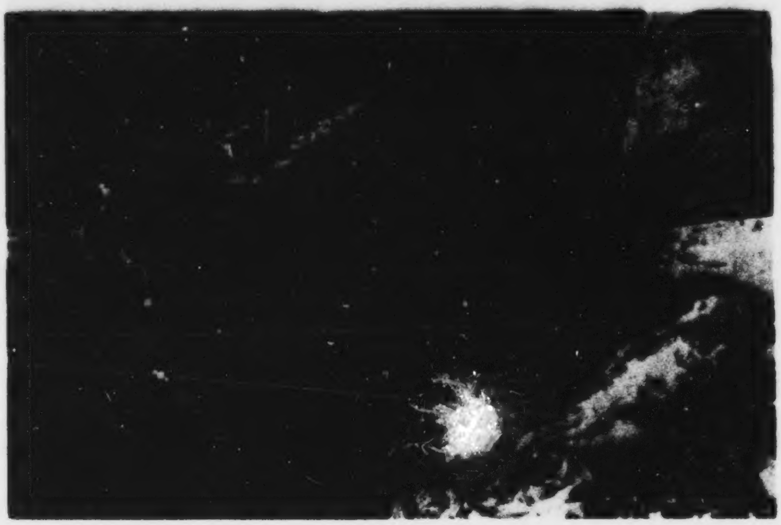
10.36 **Effectiveness measurement.** Since late 1977, the government has required that departments and agencies conduct cyclical program evaluations. The Board began to consider the development of the capability to do this two years ago and has just reached an agreement with the Office of the Comptroller General on the approach to be taken. As yet, no corporate program evaluations have been undertaken. However, the Board has done a number of studies which have looked at the impacts of its activities in some areas.

10.37 **Control of exports.** The Board is responsible for administering and enforcing the Oil Export Charge program as provided under the Energy Administration Act. In 1983-84, they collected $344 million in charges on oil and oil products that had an export value of $4.7 billion. The Board's procedures for controlling energy exports by pipeline are satisfactory, but weaknesses exist in the procedures for controlling truck exports of oil, oil products and liquid petroleum gas products. The value of such energy exports by truck amounted to $635 million in 1983, according to Statistics Canada, and the related export charges were about $81 million.

10.38 Control of exports by truck is difficult because border crossing points are designed to control entry rather than exit. The Department of Customs and Excise is responsible for enforcing the NEB Act in respect of energy export controls, and a person must have a valid NEB licence before exporting. Exporters are then expected to leave at the crossing point a statistical reporting form showing the NEB export licence number and the quantity, quality, price, etc. of material being exported. Customs collects these forms, summarizes them and reports to the NEB when all the authorized exports under a licence have been made.

10.39 This system is relatively passive; we have been informed that at some crossing points the reporting forms are simply dropped into a basket by the truck drivers, retrieved by Customs and Excise at day-end and periodically summarized. Some companies submit a consolidated form for all their exports in the previous month. It is our understanding that no check is made anywhere by Customs officials of the accuracy of the self-declaration with respect to either quantity or quality. Further, there is little to stop a person from making an illegal export. Occasionally Customs and Excise performs spot checks on outgoing tank truck traffic, and these sometimes reveal illegal exports. However, Customs does not detain shipments of oil or oil products being exported illegally; it only turns them back. Customs has the authority to detain them but, since it lacks storage facilities or authority to dispose of them quickly, it has refused to do so. Authority to dispose quickly of detained oil could be

granted by regulation under the NEB Act, but appropriate storage facilities and personnel to staff the exit lanes at crossing points would still be required.



Lowering the welded pipe into the ditch at Seagram Creek, Northwest Territories. NEB inspects to ensure that this is done carefully to avoid pipe damage.

10.40 Extensive discussions have been held on this matter between Board and Customs personnel over a period of several years. It is not now being aggressively pursued because the Board believes the problem is small and that any practical solution would be very expensive. However, in our opinion, the Board should not terminate control efforts before it determines the amount of oil or petroleum products being exported without proper licence. A process involving random spot checking of tanker trucks leaving selected crossing points could provide a valid indicator of the frequency of attempts to make unlicensed exports. A random sampling and chemical analysis of the contents of trucks with export documents could provide an indicator of the proportion of exports that are not as licensed.

10.41 **The Board should determine the amount of oil or oil products being exported illegally and, if the problem is significant, devise an appropriate system of control.**

10.42 **Enforcement.** The Energy Administration Act calls for the Board to administer and enforce the part of the Act relating to oil export charges. The Act states that a charge specified by regulation shall be levied on each cubic metre of oil exported and that each person required to pay such a charge shall file with the Board a report of the amount and type of oil exported. The Board has generally interpreted its enforcement responsibilities as being restricted to ensuring that the proper export charges have been paid on reported exports. It has not assumed responsibility for ensuring that actual exports are as reported. To do so would require additional personnel.

10.43 The Board should establish whether its current enforcement practices fully meet the intent of its legislation.

Internal Management

10.44 **Conflict of interest**. Written guidelines on conflict of interest are accepted as a condition of employment by the Board's public servants, and a committee monitors the general application of the guidelines. For Board members, the NEB Act specifies the conflict of interest requirements. We believe these procedures are satisfactory.

10.45 **Appearance of bias.** Because the Board acts as a quasi-judicial tribunal in some of its functions, staff and Board members are expected to conduct themselves in such a way as to avoid giving any impression that decisions are biased. We found that there was a code of conduct that was understood by both Board members and staff. In general, the expected conduct involves avoiding contact with applicants or intervenors immediately preceding or during a public hearing. Any necessary contact is made formally through Board legal counsel, who act as the spokespersons, with all interested parties being informed of the communication. We believe this procedure is appropriate.

10.46 **Improvement in the regulatory process.** The Board is currently engaged in a major reform of its regulatory processes. This reform effort involves extensive discussions with the regulated companies as well as with established intervenors. For example, there are projects to simplify the oil and gas pipeline regulations, to ensure compatibility of NEB regulations with those of other regulatory agencies, and to review information requirements for toll and construction cost hearings. In addition, the Board has adopted the practice of assessing the performance of its staff and the conduct of its hearings immediately after their completion, to provide the staff with feedback on their work related to the hearing and to help Board members to be more effective.

OFFICE OF THE CHAIRMAN

CANADA

BUREAU DU PRÉSIDENT

NATIONAL ENERGY BOARD
OFFICE NATIONAL DE L'ÉNERGIE

18 September 1984

Mr. Kenneth M. Dye,
Auditor General of Canada,
240 Sparks Street,
Ottawa, Ontario
K1A 0G6

Dear Mr. Dye:

The Board has no major disagreement with the thrust of your report on the Comprehensive Audit of the National Energy Board. To the extent practical, subject to budgetary and other constraints, the Board will work towards implementation of your recommendations.

Your encouragement to press on with the complex and difficult problem of measuring and assessing the efficiency and economy of pipelines will be helpful. This subject will continue to be pursued with vigour. It should be noted, however, that based on its quarter century of experience the Board feels that pipeline companies have generally acted in an efficient way, both in constructing and in operating the pipelines they manage.

The Board is continuing to study the role of comprehensive auditing of pipeline companies from the view-point of a regulatory agency with quasi-judicial responsibilities. The Board has already taken a decision in favour of a "focussed" approach to economy and efficiency auditing. To further enhance the audit function as a regulatory tool, the Board has decided to make future audit reports on pipeline companies available to the public.

..../2

OTTAWA, K1A 0E5

Canada

On the subject of potential illegal oil products exports by truck, the Board believes this problem to be relatively small and is likely to disappear in the future under conditions expected to prevail in the oil markets. With respect to additional controls that may be required we will look for assistance from Revenue Canada - Customs and Excise. The cost-benefit of instituting any additional controls would need to be taken into account.

Our audit mandate with respect to the export charge is currently being reviewed as a result of your comments. We are presently studying the level of assurance required and the cost of providing this additional audit coverage.

The Board has experienced difficulty, in applying to a small regulatory agency, the conceptual framework for program evaluation as developed by the Office of the Comptroller General. In adapting to changing circumstances the Board has reviewed its procedures and taken action to implement improvements. Examples are: the study of pipeline costs; the regulatory reform initiatives; and the updating and improving of our Rules of Practice and Procedures and many of our regulations. The Board thus believes it is complying with the spirit and intent of the government's policy on program evaluation. Moreover, it has issued a policy on Program Evaluation adapted to NEB needs and acceptable to the Comptroller General. It is proceeding to implement that policy.

The Board and its staff appreciate the courtesy of the members of your office in the conduct of what must have been a difficult audit given the nature of the Board's regulatory and quasi-judicial responsibilities.

Yours sincerely,

C. Geoffrey E

C. Geoffrey Edge

DEPARTMENT OF THE ENVIRONMENT

DEPARTMENT OF THE ENVIRONMENT

Table of Contents

	Paragraph	Page
Introduction	11.1	11–1
Audit Scope	11.9	11–2
Observations and Recommendations	11.14	11–3
Environmental Conservation Service	11.15	11–5
Water Quantity Management Data	11.16	11–6
Water Management Research	11.19	11–7
Departmental Financial Management and Control	11.24	11–7
Grants and Contributions	11.34	11–9
Federal-Provincial Forestry Agreements	11.38	11–11
Job Creation Projects	11.39	11–12
Payments to Encourage Innovation in the Forestry Industry	11.40	11–12
Miscellaneous Observation	11.42	11–13
Government-wide Audits	11.43	11–13
Management of Job Classification	11.44	11–13
Management of Travel	11.45	11–13
Management of Real Property	11.47	11–13

Exhibits

		Page
11.1	Use of Resources 1983-84	11–4
11.2	Grants and Contributions 1983-84	11–10

11

DEPARTMENT OF THE ENVIRONMENT

Introduction

11.1 This chapter reports on the second phase of a multi-year audit program which we are carrying out in the Department of the Environment (DOE). We adopted a phased approach to give Parliament more opportunity to scrutinize what is a very diversified and complex department. The first phase dealt with the Parks Canada Program which was reported in last year's annual Report.

11.2 The Acts which initiated and subsequently restructured the Department were, respectively, the Government Organization Acts of 1971 and 1979. Their effect was to amalgamate elements of various departments already involved in work related to the environment and renewable resources.

11.3 Although the overall mandate of DOE may be expressed simply as fostering harmony between society and the environment for the benefit of present and future generations of Canadians, articulating it is difficult because of administrative, jurisdictional and technical complexities.

11.4 The administrative complexities stem from the fact that the Department consists of five virtually separate entities each having responsibility for a certain component of the mandate:

- Parks Canada (a separate program) is concerned with protecting those places which are significant examples of Canada's natural and cultural heritage, and encouraging Canadians' understanding, appreciation and enjoyment of their heritage in ways that leave it unimpaired for future generations.

- The Environmental Conservation Service and the Canadian Forestry Service are collectively concerned with conserving and enhancing Canada's renewable resources of water, land, forests and wildlife and their related ecosystems, and promoting their wise use in a sustainable manner.

- The Environmental Protection Service is concerned with influencing human activities in a way that will achieve and maintain a state of the environment necessary for the health and well being of people, the health and diversity of species and of ecosystems, and the sustained use of natural resources.

- The Atmospheric Environmental Service is concerned with facilitating the adaptation of human activities to the environment.

11.5 Each of the entities is managed by an assistant deputy minister, operates with significant autonomy and delegated authority, and is highly dispersed, with regional activities throughout Canada. Each entity is analogous to a small department.

11.6 The jurisdictional complexities arise because DOE is generally dealing with natural resources that are the responsibility of another level of government, that cross international boundaries and in which many other agencies of the federal government, provincial governments and the private sector have a considerable interest. Examples of such natural resources include the atmosphere, inland waters, wildlife, forests, land and underground water.

11.7 The substantive complexities are due to the changing nature of environmental issues, their technical intricacies, and to the fact that many of the entities provide a continuing public service in such areas as weather forecasting, innovation related to forest products, recreation, support for the management of specific water projects, land use management and flood prevention.

11.8 The staff of DOE represents a wide range of professional disciplines and expertise to deal with these complexities.

Audit Scope

11.9 To give Parliament a cross-sectional view of the various levels of management in DOE, this phase reports the results of audit work carried out from three different perspectives:

- Management specific to a particular Service:
  - The Environmental Conservation Service
    - water quantity management data,
    - water management research.

Management covering department-wide functions:

- financial management and control,
- grants and contributions.

Government-wide functions performed by DOE in common with other departments:

- managing job classification,
- managing travel,
- managing real property,

11.10 The Environmental Conservation Service (ECS) was selected for review in line with our approach of conducting a phased audit of DOE. The mandate of ECS is to promote the sound management and development of three Canadian natural resources: inland waters, wildlife and land. Exhibit 11.1 indicates the relative materiality of ECS within DOE and shows the significance of Inland Waters within ECS. The two activities of water management data and water management research, which consume most of the ECS budget, are critical to the sound management of inland waters.

11.11 The financial management and control function is an essential part of the overall management of the Department. It has specific responsibility in the following areas:

- developing financial policies and standards and monitoring compliance with them;
- monitoring and advising on the development of financial systems;
- providing effective financial analysis and review of internal reports and external submissions; and
- integrating financial and operational information.

The audit of this function was carried out in Corporate Headquarters, ECS and the Atmospheric Environmental Service.

11.12 The relative importance of grants and contributions is shown in Exhibit 11.1. Since the Canadian Forestry Service accounts for 77 per cent of the expenditures, it was the focus of our review.

11.13 The scope of the government-wide reviews is commented on elsewhere in this chapter under the applicable subject area.

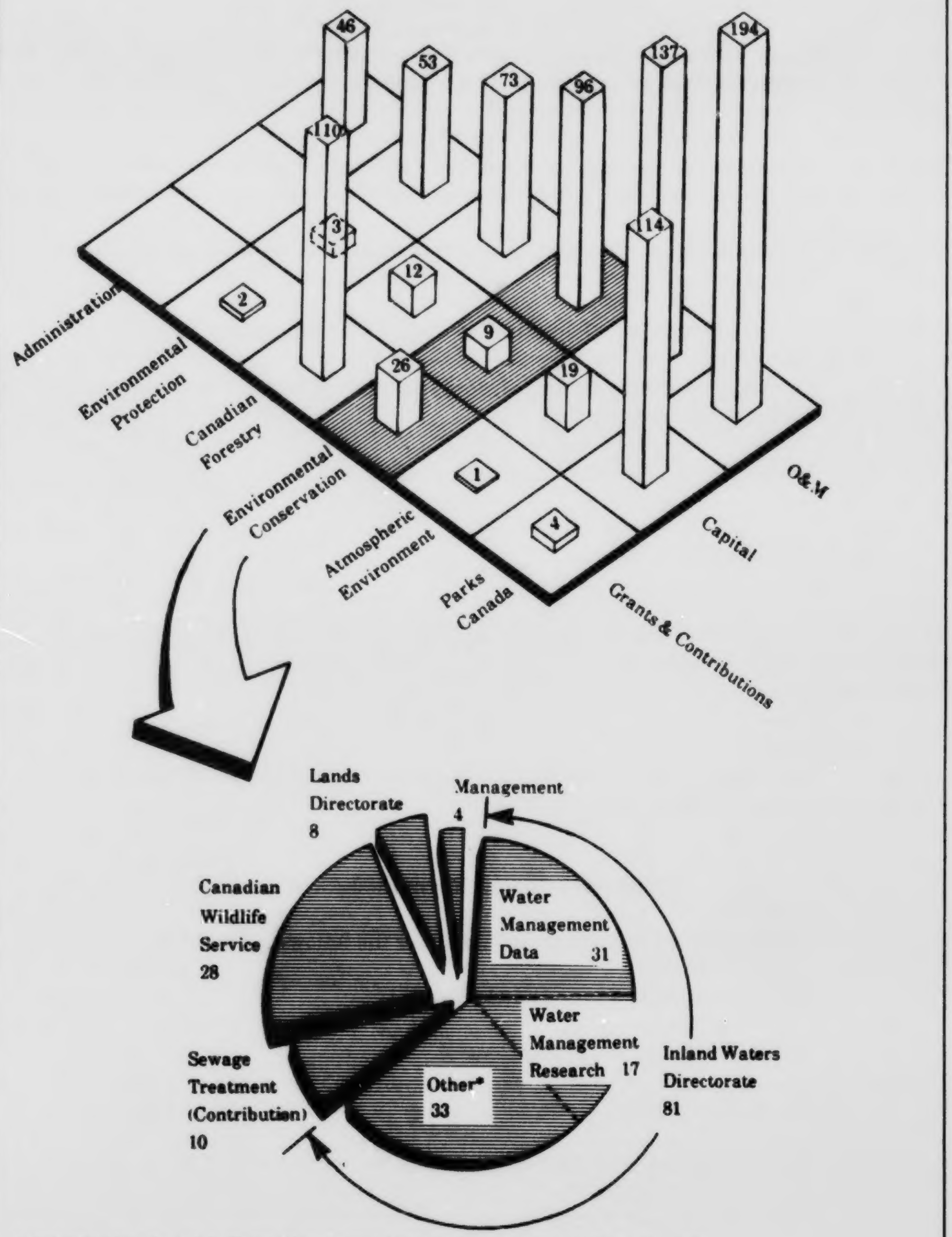
Observations and Recommendations

11.14 Our major findings, are presented under the following headings:

- Environmental Conservation Service
- Financial Management and Control
- Grants and Contributions
- Miscellaneous Observations
- Government-wide Audits

Exhibit 11.1

USE OF RESOURCES 1983-84
(in millions of dollars)

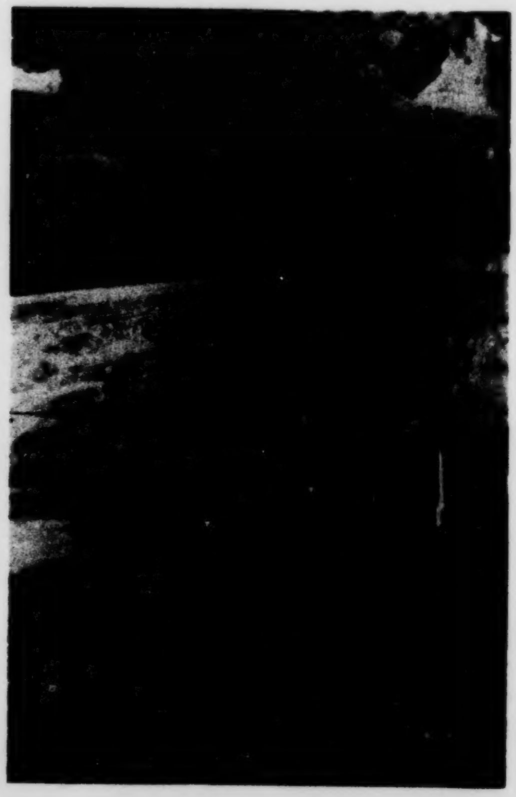


* Includes Canada - U.S. Water Management (13) and Flood Damage Reduction (9)

Environmental Conservation Service

11.15 The Inland Waters Directorate of the Environmental Conservation Service is concerned with the sound management of Canada's inland waters, in keeping with federal responsibilities and national objectives. Although the provinces have proprietary rights over the resource, there are a number of direct federal responsibilities, especially those related to international and interprovincial waters. In addition to generating information for its own water management purposes, the Directorate provides various types of information to water managers located in provincial governments, municipalities and the private sector. The information is principally derived from two major sources:

- collecting quantitative data relating to the stream flow in rivers and the levels of lakes; and
- performing applied research on a wide variety of aspects of water quantity and quality at two research institutes.



11.16 **Water quantity management data.** These data are needed for the management of international and interprovincial waters and in support of activities related to uses such as navigation, irrigation, hydroelectric energy production, drinking water, waste disposal, recreation, the support of fish and wildlife, and so on. The data are collected through a network of approximately 2,700 gauging stations widely distributed throughout Canada. The photographs show water measurement at two remote gauging stations.

11.17 The audit addressed the system for collecting water quantity data and therefore reviewed in detail the processes for substantiating the needs/requirements for the data, collecting the data at the specific gauging sites, processing the collected data, distributing the processed data and recovering the costs for services provided, where appropriate.

11.18 We found that the system was functioning satisfactorily and that due regard was being given to economy and efficiency. On the basis of the audit work performed, it is our opinion that this activity in the Environmental Conservation Service is well managed.

11.19 **Water management research.** Research is needed to give managers of water the understanding necessary to enable them to deal with the many problems they face in:

- resolving conflict relating to water use, since many uses are in conflict - waste disposal versus drinking water, navigation versus hydroelectric energy production, irrigation versus industrial use, etc.; and

- reducing inadvertent damage to inland waters caused by such occurrences as agricultural run-off, acid rain, the leaching of toxic chemicals from dumps, accidental spills of oil and chemicals, etc.

11.20 The research is performed at two institutes. The National Hydrological Research Institute, dealing with the source and destination of water in the natural hydrological cycle, is located in Ottawa; the National Water Research Institute, dealing more with the chemical and biological aspects of water, is located in Burlington, Ontario. Together, they accounted for almost 23 per cent or $17 million of the total 1983-84 budget for the Inland Waters Directorate.

11.21 Senior management agreed with our approach to treat research as a service to water management and therefore to our method of testing its use by water managers.

11.22 As a result of surveying the potential and actual uses of a sample of research projects that were under way in 1982-83, we found that less than 30 per cent had been used by managers of water. The majority of the remainder served the needs of other researchers, and therefore the research conducted at the institutes appeared to be serving academic and other learned purposes rather than providing practical support to managers in dealing with their water management problems.

11.23 Senior management of the Environmental Conservation Service agreed with our conclusion that water managers were obtaining limited benefit from the research being carried out in the two institutes. Senior management also accepted our suggestions for dealing with the problems identified, and has taken immediate steps to remedy the problems.

Departmental Financial Management and Control

11.24 As mentioned earlier, the departmental activities are diverse, geographically dispersed throughout Canada and managed under a system of delegated authority. Management control is primarily exercised by a strong emphasis on the accountability of the assistant deputy ministers and the regional directors general to the deputy minister.

11.25 Our review of the financial management function in DOE included consideration of the impact of the Department's complex organization on control and accountability. The financial function is traditionally an integral part of the control system which monitors delegated authority.

11.26 Departmental policy gives the corporate finance group functional authority over all aspects of departmental financial administration, including counterpart groups in the various Services. The Finance Group employs a persuasive approach in exercising this authority, through involvement in various management processes. However, this approach does not provide adequate independent check over delegated authority and consequent accountability.

11.27 Functional authority includes responsibility for the design, development and implementation of financial policies, systems and procedures throughout the Department, but these have not been well co-ordinated. Corporate finance has restricted its role to corporate information systems and has not become involved in developing service specific systems. For example, in the Canadian Forestry Service (CFS), regional offices were given only limited direction by the Service or corporate finance groups in terms of how CFS was to develop systems and procedures for a major job creation program.

11.28 The preparation of Treasury Board submissions has been delegated to the Service/Program level. Although a corporate finance group is usually expected to provide a substantive review of important reports and submissions, it performs only a cursory review. We found no procedures setting out the nature and extent of corporate reviews, nor any record that substantive reviews were carried out. As a consequence, there is minimal corporate involvement to act as a counterbalance to the delegated authority exercised by the assistant deputy ministers in the course of their line responsibilities.

11.29 With respect to a variety of contracts which we reviewed, we found five, totalling $1.4 million, that had not received required Treasury Board approval. Appropriate procedures to monitor compliance were not evident at that time, although the Department now reports it has established contract review committees at the Service level that will ensure future compliance.

11.30 In 1979, we reported on deficiencies in systems relating to cost recovery. Although some improvements were noted, particularly in defining the systems for costing, we found monitoring of costs and billings was still not adequate, and systems for identifying costs were still deficient.

11.31 Financial analysis has not been fully integrated into the management reporting process and, as a consequence, senior management cannot be appropriately advised of the financial implications of its decisions.

11.32 We concluded that the finance function has not yet developed an appropriate independent financial monitoring and control capability. This is particularly important for a department such as DOE with its extensive decentralization and delegated authority. We therefore recommend that:

11.33 The Department should review the financial management process and implement improvements in terms of how the Finance Group exercises its conferred responsibilities in the following areas:

- **designing, developing and implementing financial policies, systems, controls and reports;**
- **providing functional direction to counterpart groups in the various services; and**
- **contributing to management effectiveness through systematic reviews of management reports, in terms of their financial implications.**

Department's response: *The Department considers that the existing functional role of finance is consistent with the operational reality of a very decentralized department but accepts that there is always opportunity for improvement in functional management and, to that end, has recently initiated a revised role definition for the senior financial officer.*

Grants and Contributions

11.34 Grants and contributions are similar in that they both require parliamentary approval, but they differ in that grants have no conditions attached to them whereas contributions are paid only in accordance with negotiated terms and conditions that include accountability controls. Departmental grants and contributions for 1983-84 are set out in Exhibit 11.2.

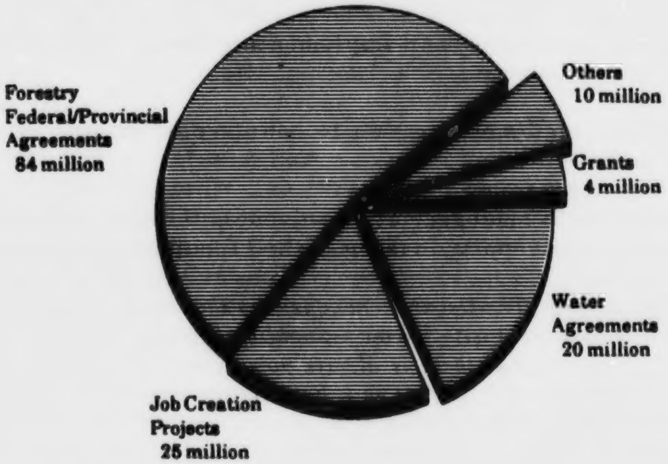
11.35 Up to 1982, the Department's annual spending on grants and contributions averaged $16.5 million, or about 4 per cent of its total annual spending. In 1982-83, however, spending in this area increased to over $133 million (16.3 per cent), rising again in 1983-84 to $143 million. The three major reasons for this increase were as follows:

- The Canadian Forestry Service (CFS) assumed the management of Federal-provincial forestry agreements from the Department of Regional and Economic Expansion (DREE) in September 1982.
- The Canada-Ontario agreement for improving sewage treatment facilities on the Great Lakes was taken over by DOE.
- Job creation projects were undertaken, in conjunction with Employment and Immigration Canada (CEIC).

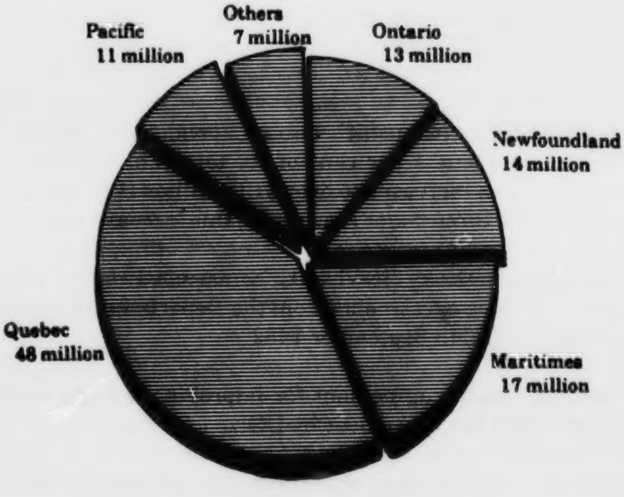
Exhibit 11.2

GRANTS AND CONTRIBUTIONS 1983-84

Departmental - - by Type
(total $143 million)



Canadian Forestry Service - - by Region
(total $110 million)



11.36 Our review of grants and contributions concentrated on CFS, with particular emphasis on the Quebec and Maritime Regions and included the following categories:

- federal-provincial agreements;
- job creation projects; and
- payments to encourage innovation in the forest products industry.

11.37 We found that grants and contributions in CFS were not being administered satisfactorily in a number of instances. Our findings by each category are presented below.

11.38 **Federal-Provincial Forestry Agreements.** The agreements were managed by federal-provincial committees which were responsible for approving the disbursement of funds consistent with the achievement of specific objectives and/or results. The proposal of projects and their implementation was mostly by the provinces, subject to the committees' approval. We observed deficiencies in the management of the agreements. For example:

- Under the Canada-Quebec agreement, a forestry road project was proposed by Quebec, at a total cost of $14 million, to link Timiskaming and Maniwaki and to provide access to forestry resources. At the scheduled expiry date of the agreement on 31 August 1984, the road was only 50 per cent complete, had incurred a cost of $23 million, and will require an estimated further $35 million to finish.

- In a related situation under the same agreement, CFS agreed in 1982 to fund jointly the completion of another road linking Manic and Gagnon that was already being constructed by the Province of Quebec. Three and one half million dollars has been spent, of which the federal government contributed $2.1 million. The central section of the road is still incomplete and is estimated to need a further $18 million for completion.

- In a forestry cultivation project, ($34 million in total) under the Quebec agreement, CFS had no record of the extent to which planned reforestation had taken place, for example, in terms of hectares planted. Furthermore, there was no indication that all woodlot owners were informed of their eligibility for, and of their benefits under, the program. As a consequence, there was no assurance that federal contributions adequately achieved their intended purpose.

- Incentives paid to woodlot owners in Nova Scotia include, in some situations, an additional amount designed to encourage reluctant owners to thin their timber stands. The extra amounts were not included in the terms and conditions approved by Treasury Board. Furthermore, incentive payments by CFS, which are based on recommendations from Provincial Government Foresters, lack sufficient supporting detail. For example, the amounts of the extra payments are not identified.

11.39 **Job creation projects**. DOE participated in a program developed by CEIC designed to create employment in the short and medium term. Under this program, CEIC paid the workers directly, and CFS reimbursed the project sponsors for their overhead. CFS expenditures amounted to $13.4 million in 1982-83 and $17.2 million in 1983-84. We observed the following operational weaknesses:

- We noted three payments to project sponsors that included $167,000 that was not in accordance with the terms and conditions approved by Treasury Board. A further concern relates to the disbursement of $4 million without adequate verification of claims. Of this amount, $1 million was paid to recipients who had not submitted the required information. As a consequence, overpayments may have occurred.

- In both 1982-83 and 1983-84, payments amounting to $1.0 million and $4.6 million respectively were made before the related funding was approved by Parliament.

11.40 **Payments to encourage innovation in the forestry industry.** CFS supports innovation in the wood products industry through payments to non-profit organizations, including certain universities, the Forestry Engineering Research Institute of Canada (FERIC), and FORINTEK, an organization devoted to wood product development. In 1983-84, the total expenditures for these activities was $8.7 million. Of this amount, $1.6 million was paid in advance of demonstrated need, and $2.3 million, paid by way of contracts, would have been more appropriately funded through the Grants and Contributions Vote where it would be more visible to Parliament when approving the Estimates.

11.41 **The Department should review all other contribution agreements with a view to identifying deficiencies and, where possible, should seek appropriate amendments to the agreements or acceptable alternative arrangements. Future agreements should be negotiated in such a way that full accountability is achieved. In implementing new agreements or changing existing ones, CFS should establish appropriate policies and procedures that reflect both operational and accountability needs.**

> *Department's response:* *In 1982, the Canadian Forestry Service assumed responsibility for the administration of then existing Federal-Provincial Forestry Development agreements. Related managerial and administrative policies and procedures of long standing could only be changed or modified very gradually, and, of course, the Provincial governments remained fully responsible for the implementation of these Agreements. Renegotiation of terms and conditions was considered to be of limited value, since most of the Agreements were within one to two years of their expiry dates. The Canadian Forestry Service has since commenced negotiating a new generation of Federal-Provincial Forestry Development Agreements, which will enable the federal government to control program expenditures and the related results achieved through direct program delivery and advanced management information systems. These Agreements*

and their related terms and conditions as required and approved by Treasury Board provide a sound basis for accountability.

Miscellaneous Observation

11.42 **Non-productive use of leased property still unresolved after 10 years.** A recommendation made by the Public Accounts Committee in 1978 regarding non-productive rent paid under a 71-year lease entered into on behalf of the Department has not yet been satisfactorily resolved. Annual rental in connection with the lease has risen over an 11-year period from $0.6 million a year to the current rate of $1.3 million a year. Further details are contained in Chapter 3.

Government-wide Audits

11.43 Three government-wide audits reported this year included DOE within their scope. The government-wide findings of these audits are given in other chapters of this Report. To the extent that they relate specifically to DOE, however, the results of these audits are summarized here.

11.44 **Management of job classification**. Processes for classifying jobs in DOE were examined in 1984 as part of our government-wide audit of the management of job classification. Audit observations were made in a number of areas, including inconsistent operating practices across the Department, delays in implementing corrective action pursuant to a Treasury Board Secretariat audit and deficiencies in monitoring classification operations. The Department has undertaken to implement corrective action in response to our observations. See Chapter 8 for details.

11.45 **Management of travel**. DOE was one of five departments selected for assessing whether travel funds, on a government-wide basis, were managed with due regard for economy and efficiency. During 1983-84, the Department reported travel expenditures of $21 million.

11.46 The audit findings in DOE were similar in nature to the findings in the other four departments. Details are contained in Chapter 7.

11.47 **Management of real property**. The government-wide review of the management of real property addressed two audit issues relating to Parks Canada: control of "reversionary" lands; and management of Ordnance, Admiralty and Dominion lands. Details of the observations resulting from this review, together with related recommendations, are contained in Chapter 6 of this Report.

DEPARTMENT OF NATIONAL DEFENCE

DEPARTMENT OF NATIONAL DEFENCE

Table of Contents

	Paragraph	Page
Audit Scope	12.1	12–1
Observations and Recommendations		
Planning, Control and Evaluation	12.9	12–2
Policy Framework	12.12	12–3
Strategic Planning	12.19	12–4
Guidance to Commanders	12.21	12–5
Feedback Mechanisms	12.24	12–6
Major Equipment Projects	12.45	12–10
Needs Definition	12.49	12–11
Requirements Definition	12.50	12–12
Acquisition	12.58	12–13
In Service	12.72	12–16
Case Illustrations	12.75	12–16
Maintenance and Supply Operations	12.122	12–29
Industrial Benefits	12.129	12–30
Capital Construction	12.142	12–33
Economic Analysis	12.147	12–34
Post-completion Review	12.149	12–34
Human Resource Management	12.151	12–36
Military Personnel Planning	12.154	12–36
Military Training and Development	12.164	12–38
Civilian Human Resource Planning	12.180	12–41
Civilian Training and Development	12.184	12–42
Human Resource Information Systems	12.187	12–42
Automatic Data Processing	12.192	12–43
Strategic Planning for ADP	12.199	12–45
System Development	12.205	12–46
Management Control	12.209	12–47
Financial Administration	12.218	12–49

Exhibits

		Page
12.1	Equipment Life Cycle Stages Reviewed	12–11
12.2	Capital Construction Projects Audited	12–35

12

DEPARTMENT OF NATIONAL DEFENCE

Audit Scope

12.1 In our first comprehensive audit of the Department, in 1982, we reviewed most of the major management systems on which the economic, efficient and effective operation of the Department depend. These were capabilities planning, equipment acquisition planning, measurement of effectiveness, human resource management, management of computer resources, and information systems. We found that improvements could be made in the Department's communications with Government, specific aspects of the management of human resources, and the management of computer and information resources.

12.2 In this audit, we examined the interaction of these systems and the manner in which they relate to the overall management process. We also reviewed some of these systems in greater detail and examined others not covered in 1982. In particular, by auditing a broad sample of equipment acquisition, capital construction and automatic data processing projects through their life cycle stages we tested the systems to see if they were producing the desired results.

12.3 **Planning, control and evaluation**. About 5,000 military and 3,800 civilian personnel are employed at National Defence Headquarters in Ottawa. These people are engaged in activities such as command and control of the Canadian Armed Forces, as well as in planning, policy and the activities involved in managing equipment, personnel, finance, supply, construction, research and development. We reviewed major management processes designed to translate government policy guidance into strategic and short-term plans, operations, outputs and reports on results, and assessed how they were interrelated.

12.4 **Equipment**. In 1984-85, the Department is expected to spend about $2 billion on new equipment, more than any other department. It represents about 24 per cent of the Department's net program expenditures. We audited seven major acquisition projects, each valued at more than $100 million, through their current life-cycle stages. This included certain tests of the in-service condition of equipment. We also reviewed selected maintenance and supply operations as well as industrial benefits relating to one of these projects – the new fighter aircraft.

12.5 **Personnel**. With 82,000 military and 37,000 civilian personnel, the Department is the largest public service employer. We reviewed military and civilian personnel planning processes, the management of certain aspects of civilian and military training, and human resource management information systems. We also performed reviews of selected Command training operations.

12.6 **Construction**. At $173 million, the Department's 1984-85 budget for capital construction is one of the largest in government. Its construction projects result from the need to upgrade facilities, respond to changing operational requirements or support major equipment acquisitions. We audited 11 construction projects valued at more than $5 million each, and one project valued at just over $3.6 million. Two of the larger projects were the Halifax Ship Repair Unit ($93.5 million) and the CFB St-Jean Base Development Project ($103.8 million).

12.7 **Automatic data processing**. The Department ranks third in government in expenditures on electronic data processing equipment and systems. About $77 million and 1,000 person-years are devoted to these purposes. We audited 13 systems through their development life cycles, and assessed the in-service efficiency and effectiveness of those systems that had reached the in-service stage. We also reviewed the applicable planning, project control and reporting processes.

12.8 **Financial administration**. When transfer payments and payments to the national debt are removed, the Department has the largest of all government budgets. We reviewed financial planning, budgetary control, forecasting and reporting systems as well as the role and responsibilities of the Senior Financial Officer in the Department.

Observations and Recommendations

Planning, Control and Evaluation

12.9 National Defence continues to adapt to integration and unification. The Department recognized that the new structure required a different classification and trade structure for personnel, different organization and management structures and new mechanisms for the highly centralized organizational and management structure. This process of change is still not complete. Many key elements of the management process continue to be adjusted to accommodate the shared responsibility and accountability that has emerged. These include mission and task statements, force structure targets, strategic planning, priority setting, human resource planning and management, operational guidance, command and control, costing, logistics and supply, and feedback processes.

12.10 The process in DND for planning, control and evaluation appears to be broadly consistent with typical government processes. It includes elements of policy development, strategic planning, operational planning, operational control and formal feedback. In practice, however, the process relies heavily on collective decision making, shared responsibility and subjective priority setting, all within the confines of government funding levels. Long-term defence strategy is affected by individual force structure decisions; these decisions are influenced by a broad range of military, economic, social, regional, technological and international pressures.

12.11 This review was designed to complement our 1982 review of planning, control and evaluation by assessing the extent to which individual systems combine to work as one cohesive management process. We studied elements of DND's management processes in the areas of:

- policy framework;
- strategic planning;
- guidance to commanders; and
- feedback mechanisms.

Policy Framework

12.12 Government defence policy is defined by Cabinet decisions on defence and other matters, by ministerial guidance to senior defence officials and by international agreements for collective defence and related matters such as NORAD and NATO agreements. It operates within the broader framework of Canada's foreign policy, which is defined by the Department of External Affairs with input from other departments, including DND. It is an amalgam of defence roles, objectives and tasks, collective defence agreements, and government decisions on force structure.

12.13 In simple terms, a military force structure consists of two major components which combine to produce military capability - personnel and equipment. The personnel component is subdivided into the classifications and trades required to fulfill the objectives established for the military. The equipment component consists of the weapons and the infrastructure that support and multiply the basic fighting capacity of the individual soldier. In addition, a force structure normally includes a structure for war, a structure for peace and a mobilization plan to permit a smooth and efficient transition between them.

12.14 The basis for the present force structure was defined in 1975, as a result of the Defence Structure Review, in terms of major equipment items and operational formations. The structure was derived primarily from peacetime, not wartime, requirements. It has been updated since 1975 by specific decisions to acquire major equipment items such as the CF-18 fighter aircraft and the Canadian Patrol Frigate.

12.15 The world military environment has changed dramatically. Throughout the 1970s, NATO strategy continued to shift from a focus on nuclear deterrence to increased emphasis on sustainable conventional capability. The force structure model adopted in 1975 is now considered by the Department to be somewhat out of date. This makes it difficult to relate capability levels to the achievement of roles and objectives. Furthermore, when the model was designed, several important factors were not adequately defined. These include support requirements for both war and peace; infrastructure; operations and maintenance; personnel classification and trade structures; mobilization; and sustainability. The full cost of the endorsed structure was never determined. The elements endorsed by Cabinet in 1975 are not consistent with resources now in place or planned and are, in some cases, no longer relevant. Although individual decisions to acquire equipment items have been accompanied

by an analysis of the affordability of each proposed item, there has been no full costing of a proposed force structure. Despite these deficiencies, the 1975 model continues to be the basis for discussions with Government on defence policy and program alternatives.

12.16 Given the absence of a clearly defined and approved long-term force structure as a planning target, expenditures on equipment acquisitions and capital construction projects, systems development, personnel and operations have not always produced the overall capability levels that would be consistent with such a structure and with approved funding levels. For example, a review of the Department's 15-year list of equipment needs demonstrates that only half of the requirements perceived by defence planners can be satisfied by the 25 to 30 per cent of the Department's budget devoted to capital. Given current perceptions of defence requirements and existing funding levels, senior management must continually compromise one or more of the major attributes of defence effectiveness, defined by DND as force structure, readiness, sustainability and combat capability.

12.17 Late in 1983, the Department initiated a Normative Planning process, based on a review of policy guidance and the strategic environment. It is anticipated that a force structure model will be produced and costed which will propose a level of military capability commensurate with current commitments. We believe that this is a necessary step toward stabilizing the force structure at some acceptable and balanced level within fiscal reality, and that the model should be presented to Cabinet so a preferred force structure can be agreed on.

12.18 The Department of National Defence should design and present to Cabinet a peacetime force structure for the longer term with an appropriate link to wartime requirements, which can be used as a basis for shorter term decisions within the Policy and Expenditure Management process. It should be consistent with defence policy and fiscal guidance and should include a comprehensive and clearly defined peacetime establishment of personnel and equipment, a proposed wartime establishment and a mobilization plan.

> *DND response: The Department accepts this recommendation. Indeed the Normative Planning Process, started in 1983, is designed to produce the structures required to support government defence policy, for presentation to the Government at the earliest opportunity.*

Strategic Planning

12.19 The defence program management system outlines a process for defining defence goals and capabilities. It involves a top-down sequence of overlapping steps beginning with an assessment of the strategic environment and ending with the appropriate defence capabilities. The capabilities planning process has been designed to provide the rationale and justification for the hundreds of individual projects in the Defence Services Program which currently consume several billions of dollars annually. We examined documents relating to the first four stages of this process and found major shortcomings. Our comments on each document follow:

- Strategic Assessments are designed to provide DND with an appreciation of current and projected international and domestic developments which may affect the security of Canada. These have been of limited use because of difficulties involved in making reliable forecasts and in obtaining consensus within the Department. There is no current formally approved amendment of the Strategic Assessment.

- The purpose of Defence Posture Assessments is to examine fundamental DND roles, objectives and tasks and the current force posture to fulfil these. The process was intended to assess alternative force postures and their costs. To date no formal Defence Posture Assessment has been produced.

- The Capabilities Planning Guidance document is intended to provide staff guidance for the development of defence capabilities and for force development. The first Capabilities Planning Guidance document was produced in 1978. It was reviewed annually and updated when required; however, updates initiated in 1982 and 1983 were not given departmental approval. A third update is being planned.

- Force Development Guides translate Capabilities Planning Guidance into more precise interpretation of policy and doctrine, manpower and equipment requirements. Force Development Guides are prepared for Air, Land and Maritime environments and are regularly reviewed and updated. However, areas of overlapping jurisdiction between the functional and operational commands cause confusion and produce inconsistencies among the guides prepared by the different environments. For example, the total required number of long-range patrol aircraft in the Air Development Guide differs from the number given in the Maritime Force Development Guide. (The duties of the Commander, Air Command and the Chief of Air Doctrine and Operations relate to functional control over all aircraft, while those of the Commander, Maritime Command and the Chief of Maritime Doctrine relate to operational control over Maritime aircraft.) A Development Guide planned for support services has not yet been issued.

12.20 DND should review the capability planning process to determine if, in its present form as described in official departmental publications, it is adequate for force development and resource allocation purposes. Once this issue has been clarified, the necessary documents should be produced, approved, and regularly updated through a formal amendment process.

DND response: *The Department agrees that such a review is necessary.*

Guidance to Commanders

12.21 Guidance to line managers is exercised through a highly centralized management process. Unification and integration were accompanied by considerable

centralization of major DND systems such as those for personnel, logistic support, procurement and financial management. The line commanders now have relatively little discretionary authority in these areas.

12.22 **A feature unique to military organizations is that the military can issue orders to subordinates, and failure to obey a direct order is a punishable offence. Orders are of two general kinds – orders for a specific occasion and standing orders. There are numerous written standing orders affecting all aspects of military life, which vary from a few pages to 10 volumes in length.**

12.23 The centralization of major departmental systems led to a requirement to make a large number of decisions in National Defence Headquarters. This resulted in a proliferation of standing orders and other directives to the Commands. The necessity, after unification, to integrate the different directives and standing order systems of the Army, Navy and Air Force exacerbated this problem. A departmental task force was established in 1983 to list all the orders and directives and determine the extent to which they had been issued by the appropriate authority, were redundant or were contradictory. In its report, the task force expressed serious concern about several aspects of the current situation. There is also concern about the high degree of centralization that the current situation reflects.

Feedback Mechanisms

12.24 In the Department's view, there are four main mechanisms for providing information to managers on various aspects of its activities:

- **performance measurement,** which is intended, among other things, to review data on readiness and combat capability;
- **program evaluation,** which is intended to review the achievement of objectives and alternatives for the delivery of elements of the defence program;
- **internal audit,** which is intended to review compliance and the adequacy of DND systems and processes; and
- **operational feedback,** which consists of reports on the results of operational exercises and the overall combat status of the Canadian Armed Forces.

12.25 **Performance measurement.** **The Defence Activity Performance Measurement System began operation in the early 1970s following the decision that performance measurement should be a normal staff function. After the 1975 Defence Structure Review, performance measures were adopted for each of the 55 operational and 11 support tasks endorsed by Cabinet. Since that time, these measures have been refined and expanded and have achieved a growing acceptance throughout DND. Readiness measures are in place, and combat capability factors, sustainability measures and task costs are still being developed. We did not attempt to assess the adequacy and reliability of the operational readiness data reported by the system. However, because of the discrepancies**

we noted in reported operational readiness at the unit level, we have concerns about the controls over input.

12.26 We noted that current plans for costing DND's tasks include only the costs of operations and maintenance without allocation of appropriate capital and overhead costs. Also, readiness information does not include data on support and logistic services, despite their importance to readiness and sustainability.

12.27 The Defence Activity Performance Measurement System should assign, to the maximum extent practicable, the full range of costs, including capital and overhead costs, against tasks, and should provide performance data on support and logistic services.

> *DND response:* *The development of efficiency measures has been initiated. As this project develops, ways of expanding the scope of costing will be examined. Work is proceeding to include support and logistic services in operational readiness as well as measures of sustainability.*

12.28 **Program evaluation.** In our audit of program evaluation, the corporate evaluation unit was the only evaluation unit we examined. When the evaluation function was formed in 1972, it was headed by an Assistant Deputy Minister, supported by a staff of 25, and focused on management processes. It is now headed by a Chief who reports to an Assistant Deputy Minister, assisted by a Director General, with a staff of 12. Until recently, the function examined only the specific areas in which senior management requested an independent assessment. Since 1981, when a program evaluation policy was issued, the organization has moved toward a more comprehensive and cyclical approach, with increased attention to measuring program effectiveness and appropriateness. With the adoption of an evaluation component structure, multi-year planning for program evaluation is improving in scope.

12.29 The program evaluation group has had difficulty meeting all the workload demands placed on it, and as a result has postponed planned evaluations. The recent adoption of a six-year assessment cycle has added to the group's workload.

12.30 We found, in two completed evaluations we examined in depth, that documentation and review of the proposed evaluation approach could have resulted in better use of data collection methods, and hence in better substantiation for many evaluation conclusions. Evaluation projects are reported to the Deputy Minister and the Chief of the Defence Staff, but action is often slow.

12.31 The Department should reconcile its long-term program evaluation plan with the resources available to carry it out.

DND response: The Department concurs with this recommendation. The major constraint has been government-imposed limitations on person-years. A submission to increase resources is now under consideration.

12.32 **Internal audit.** In our 1982 Report, we stated that the Department was reorganizing and redefining its internal audit policies and program. An audit manual, operating procedures, audit programs and training programs have been issued; however, an audit policy is still only partially developed.

12.33 The internal audit function is scattered across the Department. As part of the policy development process, the Department prepared an inventory of groups which might be considered part of the internal audit system and potentially subject to the policy when it is defined. Internal audit involves as many as 140 groups and costs about $4 million annually. The absence of policy has led to a disjointed system, where structure and accepted practices take the place of policy, and groups are allowed to evolve independently.

12.34 Although we found that the Department complies with many of the central agency standards for internal audit, we have reservations about adherence to the standards for audit scope, policy, reporting relationships, integration of audit activities and long-term planning. There have been initiatives to improve internal audit planning, and a results-oriented approach is being emphasized.

12.35 The capacity of internal audit to have a significant impact on central management processes has been low. The Director General Audit does not have the authority to undertake audits of military operations, makes few examinations of major capital projects and has not comprehensively examined core management functions such as planning, resource allocation, budgetary control and human resources. We believe that a decision on responsibilities and establishment of a sound policy for internal audit will encourage a broadened scope of audit activity. This will provide greater service to the Deputy Minister and the Chief of the Defence Staff.

12.36 We found that the departmental audit committee gives little time to internal audit, and senior management has little involvement in audit planning. Quality assurance review and reporting of internal audit efficiency and effectiveness are inadequate.

12.37 **The Department should complete the development of its internal audit policy, broaden the scope of audit activity, prepare a long-term audit plan and incorporate a process of quality assurance review to ensure adherence to standards.**

DND response: The Department concurs with the recommendation and action is already underway to address the audit finding. Measures have been instituted to improve the audit planning process and to ensure more thorough departmental coverage. The development of a quality assurance program has been deliberately

> *delayed due to recent audits and reviews by both internal and external agencies. It was considered that these reviews effectively negated the requirement to implement another review mechanism. On the assumption that reviews by Central Agencies will now decrease, it has been directed that the quality assurance program be initiated. Finalization of the departmental audit policy is well underway and is expected to be approved this year.*

12.38 **Operational feedback.** Operational exercises provide essential training for wartime conditions at all levels. If they are to form an effective part of the feedback process, exercises must be properly formulated to test the capacity of all elements of DND and the Canadian Armed Forces to work together to perform wartime missions as well as the capacity of the entire system to allocate scarce resources to critical tasks under the pressure of wartime conditions.

12.39 To achieve this, a variety of exercises is planned each year, ranging from small exercises designed to test small groups against limited objectives to large, comprehensive exercises designed to test the interaction of the entire system. Given the need for delegation of authority and responsibility essential to success in military operations, DND believes it is not practical for Headquarters to design all operational exercises. Normally, the most senior level sets objectives and then tests immediate subordinates. This results in a chain reaction of exercises at each lower level. An important testing and feedback process is initiated in which exercises are focused on the objectives issued at the top and are interpreted and made more specific at each lower level. In this general sense, the exercise process can be considered to be a two-way process operating from the top down and from the bottom up.

12.40 We found that the starting point of the entire process was missing. Canadian comprehensive exercises to test Canadian defence objectives which would involve Defence Headquarters and all Canadian Forces Commands are not imposed regularly by the Chief of the Defence Staff. The only large scale exercises involving Headquarters and all the Commands that are held on a regular basis are NATO exercises, and these are not designed specifically for Canadian purposes. Bases, formations and Commands prepare their own exercise schedules and submit them to National Defence Headquarters, where they are compiled and approved. Subsequent reports are prepared for the sponsors of these exercises, but pertinent information does not flow to Headquarters in a systematic way to advise management about the operational readiness of the Canadian Forces. The Commanders' Monthly Operational Readiness Reports provide only limited information on the capabilities of the formations.

12.41 **The Department should consider redesigning the operational feedback process to ensure that comprehensive Canadian exercises involving Headquarters and all the Commands simultaneously are regularly scheduled by the senior military official. These top level exercises should be the first step in the process, designed to test the overall capability of the forces to achieve established goals and objectives and to provide the basis for exercise planning at lower levels.**

DND response: *The operational feedback process is the responsibility of the Deputy Chief of the Defence Staff, who recently has been tasked to establish a comprehensive feedback system. This system will include exercise direction as a component of operational training.*

12.42 **A process should be established to assess operational exercise activities at all levels and prepare suitable reports to senior management on a regular basis.**

DND response: *Agreed. This will be part of the feedback process to be established by the Deputy Chief of the Defence Staff.*

12.43 To be fully useful to senior management, and to allow for comparison of outcomes to policies, plans and costs, information generated by the various feedback mechanisms needs to be co-ordinated and related to the outputs and outcomes of policies and long-term plans (what is done, and what effect it has). The Department's Audit and Program Evaluation Committee was established to improve feedback co-ordination. At present, it does this for only two of these mechanisms – internal audit and program evaluation.

12.44 **The Department should co-ordinate information on performance measurement, program evaluation, internal audit and its operational feedback to provide comprehensive and timely reports to senior management on the extent to which Defence objectives and tasks are being achieved.**

DND response: *It is acknowledged that there is a need to provide more comprehensive and timely reports to senior management. As a first step the Department intends to improve its various feedback systems. Work is ongoing to determine the best organization to consolidate the various inputs referred to in the recommendation to provide the necessary information to achieve Defence Tasks and Objectives.*

Major Equipment Projects

12.45 Since 1975, the Department has initiated several major capital equipment acquisition projects in support of the objectives and priorities stated at the time of the Defence Structure Review. Many of these projects are substantial. The New Fighter Aircraft and Canadian Patrol Frigate projects each have a total estimated cost exceeding $5 billion.

12.46 Projects of this magnitude place a significant strain on the management and personnel systems. They involve a wide range of external, interdepartmental and departmental interaction concerning regional and industrial interests, technological considerations and social factors. In spite of all of these difficulties, however, the projects must be delivered on time and within budget if the force structure required by the military to meet national and international commitments is to be supportable at an appropriate level of effectiveness within approved funding levels. The newer and more complex technologies now used in new equipment create a greater demand for experience and the stable application of military technical skills in the acquisition, project management, maintenance and life cycle support activities.

12.47 We reviewed the management of seven major equipment acquisition projects through their life cycles. Exhibit 12.1 shows the life cycle stages reviewed in this and a previous audit. We considered not only the prime equipment item but also support facilities, services, design, training, software, supply and maintenance.

Exhibit 12.1

EQUIPMENT LIFE CYCLE STAGES REVIEWED

	Needs	Requirements	Acquisition	In Service	Disposal
Leopard	X	X	X	√	
2.5-ton Truck	√	√	√	√	
Armoured Vehicle	√	√	√	√	
Delex	√	√	√		
Frigate	√	√	√		
CF-18	√	√	√	√	
Aurora	√	√	√	√	

X - reported in Chapter 2 of our 1980 Report

12.48 We also reviewed the operations of three maintenance and seven supply facilities related to the life cycles of the equipment projects and the overall readiness of the Canadian Forces and examined the management and control over industrial benefits in the New Fighter Aircraft project.

Needs Definition

12.49 Each of the projects examined in this stage could be linked to departmental objectives and tasks. However, as we discussed in the context of the need for an approved force structure plan, it is difficult for DND to demonstrate the extent to which these projects respond to long-term military effectiveness goals. This does not imply that individual projects did not result in increased defence capability, merely that the Department was unable to judge whether they demonstrated due regard for economy and efficiency in terms of contributing to a long-term force structure plan, or the extent to which they represented an optimum strategy for maximizing overall defence effectiveness with available resources.

Requirements Definition

12.50 To define requirements adequately, managers must describe the expected performance characteristics of the final product under anticipated operating conditions. In the process they must consider the life-cycle support requirements and cost, including such things as maintenance, spares, staff training, armament and the provision of other items necessary to make the equipment operational over its expected life. They must also develop plans in which military needs are balanced with funding and timing constraints, other departmental activities, and a large number of external objectives, constraints and regulations.

12.51 The requirements definition stage was reviewed in six of the seven projects. We noted two specific areas where improvement was needed: definition of support requirements and their costs, and full specification of performance expectations.

12.52 **Support requirements and cost**. The acquisition of major weapons systems still under development involves a high degree of technical risk and uncertainty, particularly in the areas of visualizing operational concepts and projecting support requirements and their life-cycle costs. In all six projects we found that the analysis of support requirements and related life-cycle costs pertaining to essential training, human resources, facilities, spares, etc., was incomplete. In many cases, costs were not fully developed by the time the project was submitted for funding approval.

12.53 Due to the complexity of the capital acquisition process and the difficulty of defining the real costs and requirements of major equipment projects, particularly those involving new technology still in the development stage, the completion of key stages of the approval process is often delayed. At times, owing to circumstances of the marketplace and the particular equipment being acquired, maintenance, logistic support and training concepts and associated funding requirements are often developed after Treasury Board and Cabinet have approved funding for the project.

12.54 For some major capital projects, approval of funding levels by Cabinet resulted in a financial ceiling that remained fixed despite changes to performance specifications, project costs or concepts of operation. In these cases, the Department faced a difficult choice between reducing the number of equipment items or deferring important support elements in the hope that they could be accommodated in future budgets. In the case of the CF-18, for example, the Department elected to defer certain components and sub-systems.

12.55 **Performance characteristics**. In two of the six projects, the Aurora aircraft and the general purpose armoured vehicle, there was some uncertainty about the desired performance characteristics. In the case of the Aurora some requirements were not included in the requirements definition.

12.56 The general purpose armoured vehicle was originally seen partly as a cross-country low-intensity combat and reconnaissance vehicle. It was also expected to serve as a tank trainer. However, according to the Department, a wheeled vehicle was stipulated, thus limiting its cross-country capabilities; and the selected vehicle is considered to be of limited value in these roles.

12.57 **The Department should review with Treasury Board alternatives to fixed ceiling funding approvals for the purchase of major equipment still in the development stage.**

> *DND response: The Department will consider the feasibility of this recommendation.*

Acquisition

12.58 Materiel should be acquired with due regard to economy, meeting the specifications developed in the requirements definition stage. Acquisition must also comply with stated government guidelines and regulations. In the acquisition stage, design competitions are held; a concept of operations and a detailed design are developed; the product is contracted for; manufacture of the equipment is monitored; and the equipment is commissioned into service. "Off-the-shelf" equipment such as the CF-18 fighter theoretically requires no design competition or detailed design but may need often extensive modification or adaptation to suit Canadian Forces' requirements.

12.59 **Design**. For five of the major equipment acquisitions we reviewed (the CF-18 fighter aircraft, the patrol frigate, the Aurora long-range patrol aircraft, the Leopard tank and the general purpose armoured vehicle), the Department held design competitions or an equivalent selection step for "off-the-shelf" equipment. Along with the designs, the Department and other government agencies reviewed performance, time, and life-cycle cost aspects of the options, as well as the industrial and regional benefits associated with each. Through a complicated process of reconciling budget ceilings, time constraints, performance and support requirements, industrial and regional considerations, the results of field trials and demonstrations of prototypes, options were selected and recommended to Cabinet.

12.60 The concept of operations for the selected equipment item, which describes the location of units, usage rates, necessary support systems and related costs, is normally developed as part of the requirements definition stage. In these five acquisitions, the concept of operations could not be fully defined until final decisions were made concerning the numbers and types of units to be purchased within the funding ceilings.

12.61 This can mean that detailed specifications, which should normally be completed immediately following the design competition or selection step, are still being settled during the production process, as was the case with the New Fighter Aircraft. This kind of uncertainty can seriously affect the total cost of delivering fully operational equipment.

12.62 **The Department should take steps to ensure that uncertainties about the concept of operations for major equipment are minimized and, as far as possible, designs are fully developed and approved before production begins.**

> *DND response:* *The Department accepts the principle that concepts of operation must be as firm as possible before weapon system production begins. The issue of fully approved and developed designs is a separate consideration. During competitive assessment of manufacturers' designs to meet DND requirements, it is not always possible for manufacturers to provide other than a basic proven design (for example, an airframe) with compliance assurance to meet Canadian requirements on subsystem performance. This limitation is due to the costs of extensive systems modifications with no assurance of cost recovery should the contractor's bid be considered unacceptable. The Department attempts to minimize risk through extensive pre-modification engineer consultation and technical assessment.*

12.63 **Contracting.** We reviewed the contracting phase of the acquisition stage in the life cycles of five of the seven major equipment projects and concluded that, generally speaking, this phase is well managed. We believe, however, that two areas deserve greater attention – delineating responsibilities in relation to other departments and reporting changes in project cost or scope.

12.64 Projects of this magnitude require effective co-operation between DND and the other departments involved. In two of the six projects we found evidence of difficulties in defining responsibilities for, and accommodating input from, other government departments. In the case of the Canadian Patrol Frigate, an important Memorandum of Understanding with the Department of Supply and Services (DSS), which defined the management of the project team, remained unsigned as the project entered the production stage, because the two departments could not reach agreement on the wording of the reporting responsibilities of the DSS member of the team. In the Destroyer Life Extension Project, the Department's attempt to achieve industrial development objectives resulted in the acquisition of an unproved radar, which still does not meet operational requirements.

12.65 Treasury Board requires departments to report changes in project scope or cost. We believe that components of the project funded through add-on contracts or through operations and maintenance budgets, which affect the ability of the equipment to perform as intended or require additional support elements to make the equipment operational, constitute changes in cost and scope which should be formally reported as such promptly and specifically to Treasury Board. In certain projects such as the New Fighter Aircraft, we could find no evidence that this had been done other than through routine semi-annual progress reports or in presentations to the Interdepartmental Senior Review Board.

12.66 The Department should ensure that significant project cost or scope changes in major capital projects are formally reported to Treasury Board as soon as they are known.

> DND response: *It is agreed that significant changes in major capital projects should be reported to Treasury Board as soon as they are known. The Department is also investigating procedures which will improve, in particular, its ability to forecast operational and maintenance budgets thereby ensuring from the outset that Treasury Board has been made aware of all potential costs.*

12.67 **Production.** During the manufacturing phase, as well as in the definition and development stages, the Department, DSS and other involved departments must have in place an adequately skilled and staffed project management team to monitor the projects, report progress to the central agencies, deal with problems and project change orders, ensure that products and components are of adequate quality and advise managers of participating departments. The process for selecting personnel who have the necessary experience, project continuity, temperament and motivation for employment on major crown projects requires greater attention.

12.68 We reviewed the production phase in six of the seven projects and concluded that management of this phase was generally adequate. We noted two specific areas where improvement was needed - quality assurance and standardization of project management systems.

12.69 In two of the six projects, there were instances where departmental quality assurance practices were not complied with. We noted that some poor quality parts were accepted for both the Delex and the 2.5-ton truck projects. In these two cases the Department had not acted to replace rejected parts within the time limits for warranty claims. These matters were reported to the Department and corrective action is being taken.

12.70 DND does not employ one basic project control system which can be tailored to any equipment acquisition project. Different computer-based project management systems are implemented for each major capital project. This is often not done early enough. Summary information on progress and costs is not standardized across projects; and information to senior management is often imprecise or tardy and is not reported often enough.

12.71 The Department should establish one basic project management system with options to select for use in all major projects.

DND response: The Department is aware of these shortcomings and has under development a project management document which will set out all the principles and procedures to see a project through the in-service phase. It is anticipated that this document will be introduced early in 1985.

In Service

12.72 The in-service stage of a project includes the activities of storage and distribution, security and custody, utilization and maintenance. We reviewed the in-service, operational readiness of four equipment items (the 2.5 ton truck, the general purpose armoured vehicle, the Aurora and the CF-18) as well as management practices at selected equipment maintenance and supply facilities.

12.73 **Operational readiness.** Operational readiness for the Armed Forces as a whole is greatly affected by the condition of equipment, the availability of spares and support services and the availability of adequately trained personnel in sufficient numbers. In four equipment projects examined, we found that readiness levels were lower than originally intended.

12.74 These operational readiness problems reflect the strains between current funding levels and the Department's perception of the requirements needed to meet its commitments. This reinforces our belief that the Department requires an approved force structure designed within the funding levels Cabinet chooses to allocate.

Case Illustrations

12.75 **Leopard tank.** In May 1976, DND received Cabinet approval to purchase 128 Leopard tanks at a cost of $187.1 million to replace the aging Centurion tanks that were used in carrying out Canada's commitment to NATO. The purchase also allowed DND to equip an operational squadron at the Combat Training Centre, CFB Gagetown and to provide tanks for use in the Armoured School in Gagetown and the Land Ordnance Engineering School at CFB Borden.

12.76 The Leopard family of vehicles consists of three variants – the C1 main battle tank, an armoured recovery vehicle and an armoured bridge layer. A total of 77 main battle tanks, 5 recovery vehicles and 4 bridge layers were delivered to the Canadian Forces in Europe. Total vehicles in Canada include 37 main battle tanks, 3 recovery vehicles and 2 bridge layers. Delivery of the Leopards was completed by July 1979.

12.77 As part of our government-wide study of materiel management in 1980, we concluded that the procurement of Leopard tanks demonstrated due regard for economy and efficiency. In this audit, our review of the in-service stage revealed that spares support for tanks was adequate to meet operational needs as DND defines them.

Maintenance on Leopard Tanks, Canadian Forces Base, Lahr, Germany.

12.78 Although standards for maintenance and repair are established, they are not used to measure maintenance performance. We observed some significant differences between the maintenance workload and available human resources, leading to large backlogs of work.

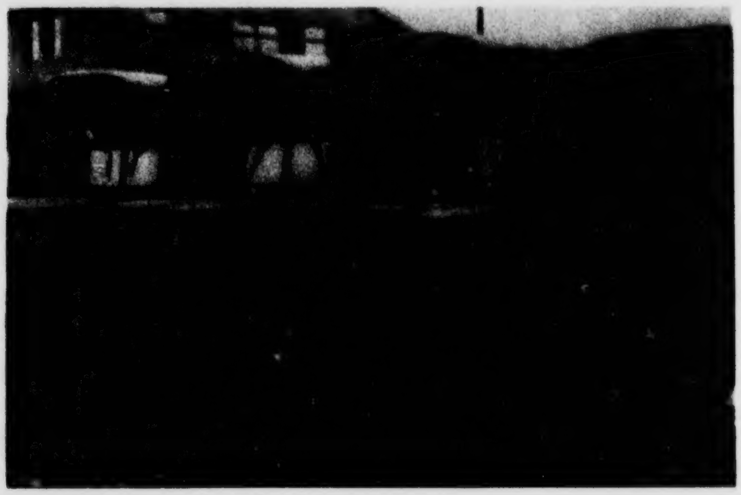
12.79 **Medium logistic vehicle**. The purpose of this project was to acquire a replacement for the 2.5-ton truck which had been in use since 1952. The acquisition involved 2.5-ton trucks, 1.5-ton trailers, shelters, special equipment vehicle (SEV) kits and associated logistic support at a total cost of $337 million.

12.80 A contract was awarded to a Canadian manufacturer in March 1981 for 2,767 of the 2.5-ton trucks, and delivery was completed by January 1984. A contract for 791 trailers was awarded to another Canadian manufacturer in 1984. In March 1984, 1,250 SEV kits were in the early stages of contracting.

12.81 As with other equipment acquisitions reviewed in this stage, we were unable to find adequate documentation defining the basis for the performance characteristics or the quantity of units procured. We found the need for service was, however, linked to the Department's roles, objectives and tasks, and that all reasonable alternatives for providing the service were considered. The choice among alternatives was based on a thorough analysis of relative costs and benefits.

12.82 Of the 2,767 vehicles purchased, 191 were extra to the regular and reserve war establishment requirements and were allocated to the militia for peacetime activities.

12.83 The Department chose to decline the supplier's warranty as too expensive at $3.5 million. This decision was questionable, not on economic grounds, but because a warranty requires the supplier to accept design responsibility for the whole vehicle, including items modified from the original design. There is some early evidence of parts defects and vehicle corrosion. A few bases have received new vehicles with signs of corrosion, and departmental quality assurance officers also detected these signs on vehicles parked at the supplier's plant. The Department is checking for corrosion as part of regular vehicle inspection.



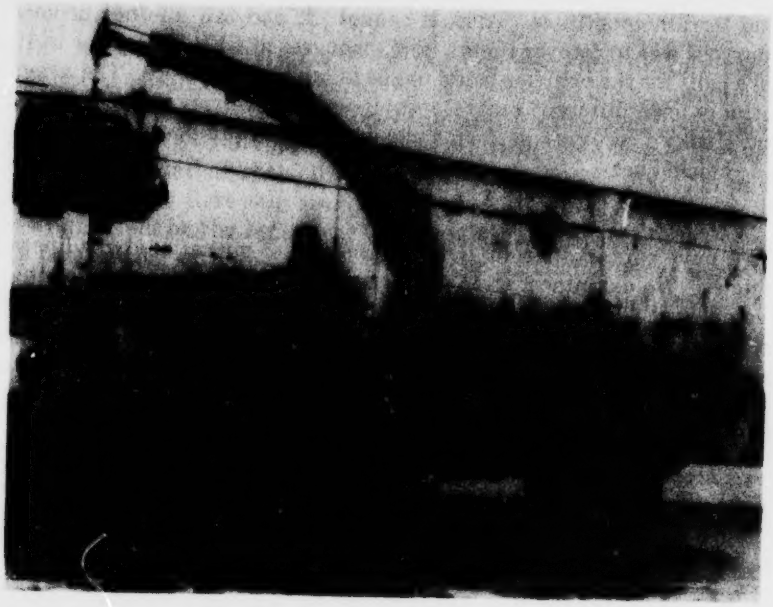
2.5-ton trucks ready for manoeuvres at Canadian Forces Base, Lahr, Germany.

12.84 Defective parts have resulted in reduced levels of operational readiness for the vehicles. Some examples of the problems we identified in November and December 1983 were failures of the power steering filter cartridge, defective dust boots, and defective radiators and brake lines. Where the deficiency was clearly the responsibility of the component manufacturer, defective material was replaced without charge.

12.85 Labour performance standards exist for repair and maintenance tasks, but are not regularly compared to the actual hours spent. Thus differences are not investigated.

Also, decisions about whether to do repairs at DND facilities or to contract them out are not always based on adequate analysis.

12.86 **General purpose armoured vehicle**. In late 1973, the Department initiated a project to acquire a general-purpose armoured vehicle. A Swiss six-wheel design was selected, and a contract was awarded to a Canadian manufacturer to build 491 of the vehicles under licence. Three variants are the Cougar tank trainer, the Grizzly personnel carrier and the Husky recovery vehicle. The vehicles were to be manufactured at a cost not to exceed $150 million in 1975-76 dollars. The first units were delivered in 1978, and delivery was completed in September 1982.



Husky recovery vehicle lifting engine.

12.87 The need for service could be related to departmental roles, objectives and tasks and the type and level of service desired was clearly described.

12.88 The analysis of alternatives and the ultimate selection of the Swiss design were found to be generally consistent with specified needs. However, by choosing a wheeled vehicle, DND accepted limited cross-country mobility under some conditions, notably thick mud, in order to obtain lower capital and operating costs than tracked vehicles require. Due to its limited cross-country mobility, the vehicle does not meet needs for reconnaissance and tactical training missions for all-arms operations in Europe and cannot serve effectively as a tank trainer. In its main functions of fire support and armoured transport for infantry, the performance of this vehicle is considered by the Department to be good.

12.89 The number of vehicles requested, originally 715, was determined according to standard brigade group requirements. An initial procurement of 491 vehicles was planned within the $150 million funding ceiling, but in December 1975, DND found that costs had escalated by about 30 per cent. A request for additional funding for the 491 vehicles was not approved, but in November 1976, Treasury Board authorized the procurement of 350 vehicles plus support material. In 1978, an amendment was authorized raising the quantity to 491, afforded mostly by using a portion of the contingency allowance and buying spares with a rebate of Federal Sales Tax.

12.90 The Husky recovery vehicle suffers from the same limitations as the rest of the vehicles in bad terrain conditions. Also, it cannot lift and tow another armored vehicle, although its purpose was to recover them. In manoeuvres at CFB Valcartier in 1982, 74 per cent of recovery calls for the vehicles could not be taken by the Husky. The armoured units therefore routinely used different recovery equipment for retrieval. Winch modifications have improved Husky's recovery performance, and mobility improvements continue to be sought for this vehicle fleet.

12.91 We have concerns about DND's reporting of operational readiness for these armoured vehicles. We examined, in the presence of officers responsible for them, 22 of a total of 146 vehicles at CFB Valcartier and CFB Gagetown. Although 100 per cent of the sample was reported by the Department as operational on that day, when we tested critical components such as gun turrets, power train and waterproofing, we found only 41 per cent of the vehicles to be without faults. The faults noted were: battery failure (23 per cent), turret not revolving (46 per cent), and swimming deficiencies (30 per cent).

12.92 Controls over maintenance labour costs were inadequate, and performance standards did not exist for comparison with actual maintenance hours required.

12.93 **Destroyer Life Extension (Delex)**. The Destroyer Life Extension Project was designed to extend the operational life of selected warships pending their replacement by new combat ships. The project involves purchasing new equipment to replace obsolete navigation, communication and combat systems in 16 steam destroyers. Of the 16 ships, 10 will receive varying amounts of the Destroyer Life Extension improvement package and all 16 will receive improvements designed to maintain them in "safe to go to sea" condition. The project represents the minimum work necessary to maintain adequate numbers of operationally safe ships to fulfil both national and international commitments pending the acquisition of replacement vessels.

12.94 In 1980, Treasury Board approved a program of $213.8 million in capital and operations and maintenance funds for the refit of 16 ships, with the program to be completed by 1987.

12.95 One of the stipulations was that 4 ships would be refitted in the Department's Pacific Coast Ship Repair Unit and the remaining 12 ships would be contracted to private yards on a competitive basis. During 1983, 3 destroyers underwent Delex refit, bringing the total of ships that have received new equipment to 10.

12.96 We found the Department had completed a thorough analysis of the options available to maintain a combat-capable fleet. Support requirements for the project were adequately defined, but full life cycle cost estimates were not available.

12.97 Acquisition is being carried out in accordance with procedures set out in DND's Project Implementation Plan and, as experience is gained, actual time and cost are being reduced on subsequent refits.

12.98 Although DND originally defined requirements for an off-the-shelf, proven radar unit for the Delex project, radar being developed by a Canadian company was promoted by the Departments of Regional Industrial Expansion and Supply and Services and was accepted by DND in response to a government requirement for Canadian content. The most recent evaluation by the Department indicates that delivery of this system will be three years late. The first ship scheduled to receive it will have had to use a less than adequate system lent by the company's United Kingdom parent while the second and third ships will be outfitted with an uproven commercial version of the required radar. We also noted that the Department is sharing with the company the cost of eliminating an unexpected and unacceptable fault, detected in the first development model, at a total cost to date of $400,000.

12.99 We noted that there were occasional weaknesses in quality control. As a result, faulty high pressure air valves were accepted from the same Canadian supplier on two successive occasions. The second shipment of valves was supposed to have been corrected by the supplier to overcome defects discovered in the first. Both shipments had been fully paid for at a cost of $35,000, and DSS could not obtain a refund because the warranty period had expired. The scrap valves are being disposed of, but the same supplier has been invited by the Department of Supply and Services to bid on resupplying valves for the same application.

12.100 **Canadian Patrol Frigate**. In December 1977, Cabinet authorized a $63 million project definition study for Phase I of a ship replacement program. Phase I involved the acquisition of six ships. A program office was established, and Canadian shipbuilding firms were invited to submit proposals for the design and development of six fully supported ships. In July 1983, it was announced that the competition had been won by an east coast shipbuilding company. The contract calls for construction of three ships in that yard and sub-contracts for three to two other yards in the province of Quebec. Delivery of the first ship is expected in 1989 and the last by 1992. The Department has estimated that distribution of the work among three firms will add approximately $58 million to the cost of Phase I. The total estimated cost of Phase I is $5.5 billion, of which $234 million will be spent in 1983-84.

New mast being installed on HMCS Nipigon as part of the Delex project.

Artist's conception of New Canadian Patrol Frigate.

12.101 The need for the frigates was defined by the Government's decision to maintain a combat-capable surface fleet and by the aging condition of most of the existing fleet. We found the development of options was linked to current DND tasks.

12.102 Requirements were adequately defined for the primary characteristics and support requirements of the frigate. The preferred option was compared in terms of combat capability with over 100 recently designed similar vessels. Final definition of the requirement reflected input from industry and continuing study and design work by the Department. However, there was little evidence of the use of full life-cycle cost estimates in evaluating the options. The Department has no recently acquired vessels to provide life cycle cost records on which to base estimates for the Frigates. Most analysis focused on acquisition costs, which represented only 25 to 30 per cent of the full life-cycle cost.

12.103 **New Fighter Aircraft.** In April 1980, Cabinet selected the CF-18 as Canada's new fighter aircraft. DND was authorized to procure 137 aircraft and associated logistic support (e.g. spares, maintenance and training equipment) from the American manufacturer within a total cost ceiling of $2.99 billion Canadian in 1979-80 dollars (or $4.02 billion in budget-year dollars). In 1981, the United States Government agreed to waive part of the research and development recoupment charges for the CF-18 project, and the Canadian Government offered, under a dollar-for-dollar matching arrangement, to provide funding for the project equal to the amount waived. DND then exercised an option in the contract to acquire one additional aircraft. As a result, the project budget baseline was raised to $3.07 billion Canadian (1979-80 dollars), with a budget-year ceiling of $4.10 billion. Later in 1981, DND secured approval to increase the budget-year ceiling to $5.19 billion to offset the effects of rising inflation and exchange rates.

12.104 The CF-18 will replace the full fleet of CF-101 and CF-104 aircraft and those CF-5 aircraft committed to NATO, all of which entered service in the early 1960s. The new multi-purpose fighter aircraft will perform sovereignty and air defence missions in Canada; in Europe and Norway, they will perform air-to-air and air-to-surface missions.

12.105 Our review of the early stages of the aircraft life cycle indicated that the combat capabilities required and operational missions to be performed in NATO and NORAD were clearly defined. The approximate number of aircraft to be acquired was directed by Cabinet.

12.106 The New Fighter Aircraft competition was held in two phases. During 1977 and 1978, the Department's evaluation team conducted rigorous military evaluation programs with the six competing aircraft, and the Interdepartmental Project Management Office assessed the proposals.

12.107 In the second phase, the competition was narrowed down to the CF-16 and CF-18 proposals. We found the military capability and proposal analysis to be thorough. However, due to the newness of the aircraft and the limited performance data available to the analysts, much of the information was estimated from historical information for other aircraft. The project brief submitted to Treasury Board in 1979 did not disclose the level of reliability and the degree of risk associated with all of the logistic support elements. Also, it did not set out clearly which mission equipment was to be procured in 1980 and which associated equipment was planned for later procurement.

12.108 During 1980 and 1981, the Project Management Office began defining requirements for initial spares and maintenance support equipment for the aircraft. At this stage, rough cost estimates were developed by office staff based on contractor costing information and data in the Canadian Forces Supply System. Concurrent with this activity, the DND Project Management Office and the contractor negotiated a Basic Ordering Agreement. The latter defined contracting procedures and methodology for determining the prices of items supplied by the contractor.

12.109 Under the agreement, the contractor initially provides "not-to-exceed" price proposals which have so far been 35 to 45 per cent over expected final costs. Fixed price incentive ceilings are subsequently negotiated at 120 per cent of the target costs specified in the contracts. Due to the structure of the agreement, the final prices payable for contracts will not be known until some time after 1988; however, the reconciliation at that time will establish aggregate costs for the aircraft and for its support materiel and may never resolve individual parts prices.

CF-18 at Canadian Forces Base Cold Lake, Alberta.

12.110 In our review of the first three years of spares and maintenance support equipment acquisition, we observed the following:

- Information from six different systems is being employed to monitor orders and receipt of goods and for commitment control. However, it was not until September 1983 that any of these systems provided for the comparison of costs and estimated costs of requirements with allocated budget levels.

- Cost estimates provided by the contractor at the first stage of the provisioning process were found to be unreliable. Major discrepancies occurred between the initial estimate and the "not-to-exceed" price proposals. Examples are provided in Table 1.

- The initial provisioning budget level allocation for spares was fully committed in the last half of 1982. This contributed to price proposals on 75 contract demands, valued at $125 million, being allowed to lapse. To allow essential spares to flow to the Armed Forces to meet requirements, the project staff structured the spares agreement and parts prices immediately payable to allow for further negotiation.

- Procedures for acquiring spares have not followed the project brief, and approximately $200 million has now been budgeted outside the project for initial spares requirements. As a result of this change, approximately $75 million to $100 million in initial spares requirements properly chargeable to the project will now be funded outside it.

- Procedures for acquiring repair and overhaul start-up costs have not followed the project brief. An estimated $148 million properly chargeable to the project capital budget will be charged to operations and maintenance.

Table 1

Item Description	Initial Cost Estimate ($1980-81)	"Not to Exceed" Price Proposal (1981-1983)	% Increase (Decrease)
Antenna Assembly	$ 9.00	$ 2,077.29	22,981
Resistor	$ 1.19	$ 299.19	25,042
Self Locking Bolt	$ 2.00	$ 140.43	6,921
Door Hinge Pin	$ 50.00	$ 1,495.61	2,892
Circuit Card Assembly	$ 180.00	$ 4,920.74	2,633
Tube Assembly	$ 5,546.24	$ 899.40	(516)
Manifold	$ 3,000.00	$ 12,008.71	300
Actuator	$ 1,008.00	$ 3,095.61	207
Fuel Tank	$ 26,376.00	$ 45,227.75	71

12.111 Because the funding ceiling of $2.34 billion was fixed in 1977, before a number of project requirements could be precisely specified, some of the requirements identified had to be deferred. Over the succeeding seven years, as more information has become available, the Department has identified approximately $3.5 billion in projects related to, but not included in, the CF-18 purchase. These range from items considered indispensable to those classed as highly desirable for procurement when funding permits. All will have to be judged within the tight funding constraints of the Defence Services Program, along with many other Canadian Forces requirements.

12.112 The Department sought approval from Treasury Board in 1980 to include in the project only an initial supply of weapons for immediate operational requirements. Cabinet acknowledged that the Department would require additional munitions and attrition aircraft later in the decade.

12.113 For the most part, we found that the project management office was controlling costs and the allocation of funds in accordance with Treasury Board authorizations. Although the original project brief did not define these specifically enough, the project is being contained within the authorized budget through departmental decisions to charge spares and maintenance equipment costs, currently estimated at approximately $225 million, to operations and maintenance.

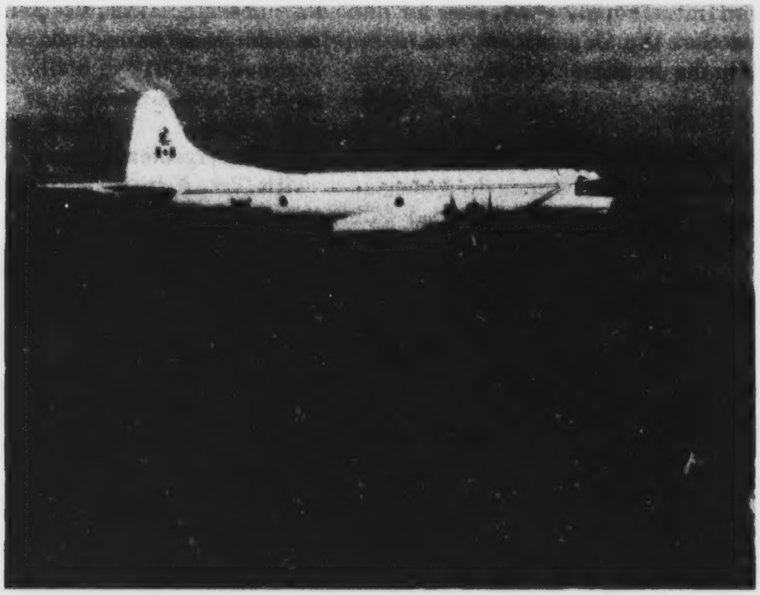
12.114 Our audit included a review of the arrangements between the Department of Supply and Services and the United States Government's Defence Contract Audit Agency for the audit of DND contracts with the CF-18 manufacturer. We found that DSS had failed to provide adequate working direction to the Agency for performance of audits during or following execution of the CF-18 contract. As a result, during the 1980-83 period, the Project Management Office has not had assurance that the contractor is recording only costs applicable to Canada against the contract.

12.115 CF-18 serviceability levels for the first 18 months of service (for 32 aircraft) were significantly lower than DND's target for mature aircraft in a steady state of operation. To meet operational requirements, the Department obtains parts not in stock by either expediting procurement or removing them from aircraft undergoing maintenance. The Department does not view this extra effort as abnormal, considering the immaturity of the aircraft and the experience of the United States Navy and Marine Corps with it.

12.116 **Aurora long-range patrol aircraft**. In July 1976, a contract was signed with an American manufacturer for the purchase of 18 Aurora long-range patrol aircraft and associated support equipment at a cost of over $1 billion, as replacements for the CP-107 Argus aircraft, in service since 1958. Deliveries of the aircraft to CFB Greenwood and CFB Comox took place between May 1980 and July 1981.

12.117 We found that the need had been well defined and related to program tasks and objectives. The primary characteristics of the aircraft were adequately defined, but there were major omissions in defining support requirements.

12.118 Acquisition of initial provisioning was delayed by late definition of the parts required and long delays in the delivery of many items. As well, the Aurora has been plagued with epidemic parts failures.



Aurora long-range patrol aircraft on surveillance flight.

12.119 Kits of spare parts that were needed to service aircraft on deployment at NATO bases were mentioned in the requirements definition but were not specified in the Treasury Board submission or the acquisition contracts. Two deployment kits are now being acquired. To date, parts needed on deployment have been withdrawn from limited regular stock, reducing the inventory available for supporting the remainder of the fleet. This has helped to aggravate shortages of spares which have led to extensive robbing of aircraft for parts, a procedure that increases the ensuing downtime. At CFB Greenwood, for example, when one of the 14 aircraft is grounded for several days for either repairs or scheduled maintenance, it is placed in "rob status" and parts are removed from it to repair other aircraft. No individual aircraft is left in this state longer than 60 days, but the base has had the equivalent of at least two Auroras in this condition continuously since the aircraft entered service in 1980. In addition, it has a significant number of aircraft continuously on the ground for inspection or repair procedures. The average serviceability rates achieved for the first two and a half years of operation was the minimum necessary for carrying out the flying program.

12.120 Every flying hour of every Aurora is programmed to some purpose, and the squadrons at CFB Greenwood have managed to accomplish their flying programs. Standards of utilization are established, and actual performance is recorded and monitored for the fleet, which is shared between the three squadrons on the base.

12.121 No suitable quantitative standards are available for repairs to the Auroras. The primary spur to achieve efficiency is a daily declaration of when each aircraft will be made serviceable. Daily effectiveness is assessed by the extent of adherence to these declarations. Quantitative indices, such as the number of maintenance hours per 1,000 flying hours, give a rough idea of overall efficiency, although this is too broad to use to exercise close control.

Maintenance and Supply Operations

12.122 **Maintenance**. We reviewed the Ship Repair Units in Halifax and Esquimalt and the Workshop Depot in Montreal. The Repair Units carry out repairs for Maritime Command, and the Workshop Depot primarily overhauls Mobile Command equipment and provides major repair service support to ships in refit at civilian facilities on the St. Lawrence River. These facilities undertake maintenance tasks for other Canadian Forces units in the area and make components and assemblies for the defence supply system. NATO member ships are also served on request. The three major facilities also perform a role in trades training. The Repair Units, although under military command, are exclusively civilian. The Workshop Depot is predominantly military.

12.123 In our 1980 study on materiel management, we reported concerns about DND systems and processes for defining capacity, measuring efficiency, developing appropriate work standards and cost information and reporting performance for these facilities. In this audit we noted that, while some progress had been made, essentially the same problems exist. None of the repair facilities had adequate measurement systems in place.

Atlantic Ship Repair Unit, Halifax.

12.124 The equipment Maintenance Management Information Systems used in the Air, Land and Maritime Environments do not provide information sufficiently promptly to be of use in daily maintenance decisions. Because the systems are not on-line, they are useful primarily for statistical references in engineering decisions at National Defence Headquarters.

12.125 **The Department should take steps to improve the management of its three primary maintenance facilities in the areas of capacity definition, efficiency measurement, work standards, cost information and reporting performance measurement for both peacetime and wartime conditions.**

> *DND response: Work will continue to address these concerns while recognizing that the facilities are faced with problems of fluctuating workloads, a need to maintain a capability for war, and changing demands as newer equipments are acquired and enter into service.*

12.126 **Supply**. The Canadian Forces Supply System is the key peacetime system for planning, procurement, stocking and movement of materials and supplies to all units of the Canadian Armed Forces in Canada or overseas. It manages approximately 1.5 million line items valued at more than $10 billion, of which $7.7 billion is at bases and stations and $2.4 billion at supply depots. About $1 billion is spent annually on supplies.

12.127 Four major supply depots in Edmonton, Toronto, Montreal and Moncton serve national and world-wide demands. Each is required to provide a fully integrated service to land, sea and air operations primarily within its own geographical location and also, as required, to any other Canadian Forces location.

12.128 We reviewed supply and storage operations at three supply depots, two maintenance depots and one base facility. This included work planning, utilization of resources, control of materiel and performance measurement. Our overall opinion was that the peacetime operations of the supply facilities are generally well managed. We reported some specific concerns and these are being addressed in a current project to upgrade the supply system. We did not examine the potential wartime capacity of the system during the course of this audit.

Industrial Benefits

12.129 The Industrial Benefits Program requires agreement by parties contracting with the Government of Canada, as a consideration of being awarded a contract, to provide economic benefits to Canada in ways specified in the contract.

12.130 An offset is one form of industrial benefit. It can be an investment, technology transfer or work not necessarily directly related to a government purchase abroad but placed in Canada by the foreign contractor, to offset the purchase abroad. The other form of industrial benefit is direct Canadian content, where the equipment contracted for is built partly or entirely in Canada.

12.131 Starting in 1975 with DND's purchase of the Aurora long-range patrol aircraft, and followed by other significant military acquisitions such as the Leopard tank and the new fighter aircraft, industrial benefit arrangements amounting to several billions of dollars have been negotiated.

12.132 The formal contracting process is the responsibility of the Department of Supply and Services, with legal advice provided by the Department of Justice. Responsibility for administering industrial benefits, which includes interpreting the Government's intent regarding industrial benefits and spearheading the negotiation of these benefits in acquisition contracts for major crown projects, is assigned to the Department of Regional Industrial Expansion (DRIE). Prior to reorganization in December 1983, this activity was carried out by Industry, Trade and Commerce. DRIE has only limited influence on the purchase of goods or acquisition of services subcontracted in Canada by a foreign supplier; the purchase remains the prerogative of the supplier. However, DRIE is required to facilitate the consideration of potential Canadian subcontractors through assistance to them in bidding and preparing for production. The Minister of DRIE has full discretion to allow, or disallow, any transaction not specified in the contract claimed by a foreign supplier as an eligible offset under the terms of the procurement contract.

12.133 Our audit assessed the adequacy of the management of industrial offsets as part of the major capital procurement contract for the new fighter aircraft. Industrial benefits to Canada from this contract are expected to total approximately $3 billion and include investment commitments, contracts with Canadian suppliers for goods and services, and transfer of technology.

12.134 We have a number of concerns about the following aspects of the management of industrial benefits: departmental roles and responsibilities; regional distribution of contracts; procedures to approve offset claims; reporting of performance; and audit.

12.135 **Departmental roles and responsibilities.** Administration rests mainly with DRIE, which approves claims for benefits, but DRIE, DSS and, formerly Industry, Trade and Commerce have taken lead responsibility for different equipment at various times, and their objectives overlap in the area of funding sources of supply for government needs. As a result, the total management of benefits has lacked clearly defined objectives, policies and plans. These have had to be clarified in respect of each major Crown project, both informally and in the memoranda of understanding between the departments involved. In turn, procurement contract wording has reflected this lack of definition. Prime contractors supplying DND's equipment have been able, in some instances, to negotiate favourable conditions based on the wording of industrial benefit provisions in offset contracts; however, additional experience with the administration of CF-18 benefits has led to the development of a model contract which is aimed at minimizing this phenomenon in future programs.

12.136 **Regional distribution of contracts.** Regional distribution of benefits did not become a controversial issue until it became evident that Ontario's manufacturers were doing most of the bidding and were being awarded most of the contracts for components and fabricated assemblies for the CF-18 fighter. The Industrial Benefits Program could not be specific with respect to the regional distribution of industrial benefits and, except for specific investments in plants in Quebec, the CF-18 acquisition contract had not stipulated that offsets be distributed regionally. The contract was signed before the aircraft supplier was advised that offset contracts would be expected at certain forecast levels in the provinces. DSS feels that including any regional distribution of industrial benefits as a condition of the contract might have significantly affected the cost of the acquisition.

12.137 Industry, Trade and Commerce contributed to better regional balance by helping regional firms to bid successfully for CF-18 offset contracts.

12.138 However, administration of industrial benefits began with inadequate staffing of the Industry, Trade and Commerce component of the CF-18 project team. As well, the team had to contend with a level of complication not anticipated at the outset of the project. Dealing with the problems associated with regional distribution of work was one source of unanticipated workload.

12.139 **Procedures for approval.** For the CF-18 project, DSS challenged administrative approaches taken by Industry, Trade and Commerce, and tried to reverse that department's acceptance of an offset claim. The project ran for 18 months without a signed memorandum of understanding between DND, Industry, Trade and Commerce and DSS. During this period the three departments were able to progressively resolve most of their differences.

12.140 **Reporting and audit of claims.** Procedures to ensure that claims for benefits are acceptable have evolved over time and DRIE is now documenting them. Samples of claims are normally verified by telephone. We found that claims under $5,000 amounted to only 5 per cent of the total benefit value yet totalled 34 per cent of the number of claims. Because all claims were reported using the same complete set of procedures, considerable administrative resources were required – more than Industry, Trade and Commerce was initially able to make available to the team.

12.141 **Terms and conditions should be clearly stated in all contracts for major equipment acquisitions in such a way as to ensure that they conform to the objectives of the Industrial Benefits Program and incorporate lessons learned from previous contracts. The contracting authority should monitor adherence to the contract.**

DND response: The Department fully supports the recommendation that industrial benefits should be clearly stated and carefully monitored.

Capital Construction

12.142 In 1982-83, the Department of National Defence spent $112.4 million on construction and acquisition of land, buildings and works. According to the 1984-85 Estimates, $173 million will be spent on approximately 50 projects. The above figures do not include construction projects in support of capital equipment acquisitions, such as the New Fighter Aircraft program, that are funded from the capital equipment budget. These amounted to $38.3 million in 1983-84.

12.143 Capital construction needs stem from operational and training needs, NATO commitments, and the depreciation of existing facilities. Each year, bases prepare a listing of priority capital projects which are included in Base Development Plans. These are reviewed at the Command level and then at Defence Headquarters, where an integrated listing of priorities is prepared. From this, a tentative three-year major capital program, based on peacetime requirements, is developed and approved by senior management.

Aerial view of St-Jean Base Development project.

12.144 After Treasury Board approval to enter into construction, Defence Construction (1951) Ltd., a Crown corporation reporting to the Minister of National Defence, calls tenders, evaluates proposals, selects a contractor and makes a submission to Treasury Board for approval. During construction, Defence Construction performs the function of contract management, which includes site supervision, and recommends acceptance of the completed project to the Department.

12.145 We examined 12 capital construction projects whose costs totalled $307.9 million, or 79 per cent of the value of current DND projects for which Treasury Board approval has been given. We looked at each in the needs definition, requirements definition and construction stages of its life cycle (Exhibit 12.2). Observations about the in-service aspects of the management of real property in National Defence are included in Chapter 6 of this Report, Management of Real Property.

12.146 On the basis of our review, we concluded that capital construction was managed satisfactorily, with the exception of the CFB St-Jean Base Development project, in which there were significant design, scope and cost problems. These problems have not recurred in more recent projects. We found that DND generally complied with applicable legislation, Treasury Board requirements and departmental policies respecting management of capital construction projects. Two areas where we believe improvement is necessary are economic analysis of projects and post-completion review.

Economic Analysis

12.147 Our study on Planning Capital Acquisition Projects, described in Chapter 3 of our 1978 Report, endorsed the process of Base Development Planning in the Department as a means of encouraging economic and efficient use of construction budgets. The projects we reviewed in this audit were all on strategically important bases for which Base Development Plans had been prepared and approved in principle by the Department.

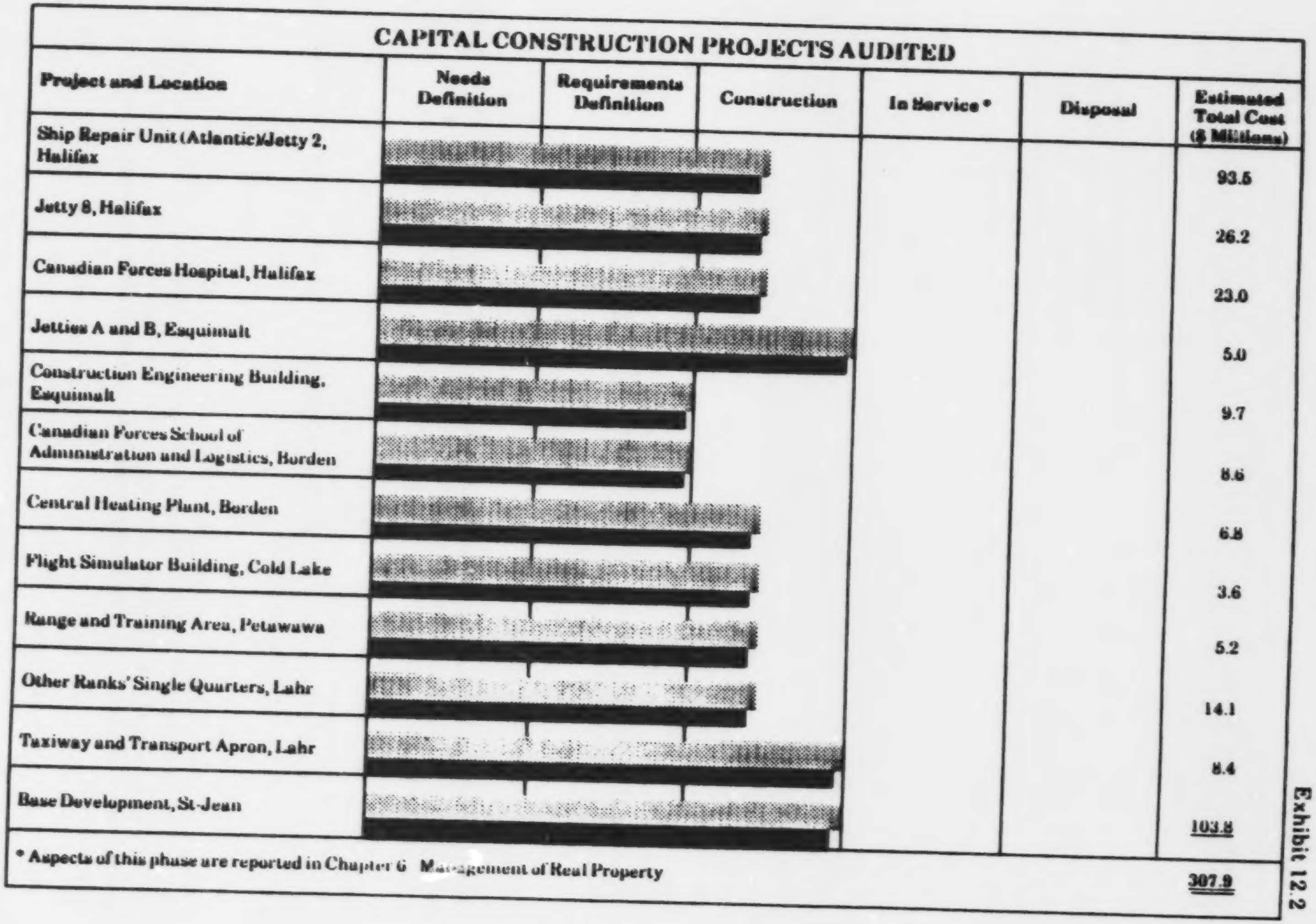
12.148 Provision for a particular service in a Base Development Plan affirms the need for that service. In the context of a particular project, therefore, the quantitative emphasis tends to be on the cost of the project rather than on the economic benefits to be derived from its use. We found that when the economic benefits of a project were set out in DND documents, they were imprecise. We believe that projected economic benefits of construction projects should be properly disclosed and the in-service phase of projects subsequently evaluated to determine whether economic benefits, such as forecast operating cost savings, have been realized.

Post-completion Review

12.149 At present there is no independent, formal post-completion review of projects to evaluate them in terms of meeting needs for service or achieving forecast economic benefits. The only post-completion reviews of projects are done by informal committees of persons who were involved.

12.150 The Department should implement a program of independent post-completion evaluations of construction projects. This need not involve all projects, but should cover a representative sample of projects each year.

Exhibit 12.2



CAPITAL CONSTRUCTION PROJECTS AUDITED

* Aspects of this phase are reported in Chapter 6 Management of Real Property

DND response: The Department agrees that a post-completion evaluation should be conducted and be at least as thorough as the approval process which now takes place to compare issues such as operational requirements satisfaction, total cost and milestones.

Human Resource Management

12.151 Person-years authorized for the Department for 1984-85 are 82,047 and 36,708 for military and civilian staff respectively, making the Department the largest public sector employer in Canada. Payroll costs, including salaries, training, pensions, contributions and benefits will account for roughly 40 per cent of the Department's estimated expenditures for 1984-85.

12.152 Our audit of human resource management focused on civilian and military personnel planning; civilian and military training and development; and personnel management information systems. We also reviewed progress on the recommendations made during our 1982 comprehensive audit.

12.153 Processes for classifying jobs in DND were examined in 1984 as part of our government-wide audit of the management of job classification, reported in Chapter 8. We observed that job classification practices were generally appropriate to ensuring good control over classification decisions. These practices included strong position establishment controls, effective quality control procedures, provision for the objective review of contentious classification decisions, as well as systematic audits of the classification system including the accuracy of decisions.

Military Personnel Planning

12.154 Personnel policies provide guidance for a wide range of activities that mould and shape the forces. These include recruitment, training, feeding, housing, medical care, promotion, discipline, awards and retirement. The personnel system reacts to the overall force development objectives and to inputs from all other major components of the departmental management system. The system is also used to control establishment changes and implement manning priorities. Its efficiency and effectiveness can have an important impact on the preservation of essential military skills and knowledge, on morale and on current military effectiveness.

12.155 The process involves accepting force development inputs concerning, for example, the kinds and numbers of soldiers, sailors and airmen required for the Canadian Armed Forces over the longer term, and translating this direction into a planned process of establishment changes, manning changes and interrelated policies necessary to achieve the selected goals.

12.156 Military personnel planning is particularly complex. The armed forces comprise not only very large numbers of personnel but also a structure to which there is limited lateral entry above the recruit level and little lateral mobility across classifications and trades. In most cases, it takes 20 or 30 years to reach the managerial levels of individual military classifications and, as a rule, servicemen spend their working lives in one classification or trade.

12.157 Further factors which complicate military personnel planning are, first, the strong links between major equipment purchases and the personnel establishment structure required to operate and maintain this equipment and, second, the linkage between peacetime personnel establishments and the establishments required to meet wartime commitments. We therefore reviewed the force development policies that should provide the military personnel planning system with its overall planning objectives and considered the impact of the linkages that should exist between the capital equipment acquisition process and the logistics system for both peace and war.

12.158 We observed that force development policies were not adequately defined or effectively communicated. The process of redefining the classification structure after unification to replace the old Army, Navy and Air Force structure is still evolving. This has made it difficult to design an establishment linked to the long-term force structure needed by the forces or to the establishments required for wartime operations. As a consequence, the manning function and the short-term policies related to day-to-day manning issues have become the primary focus of many aspects of the personnel system.

12.159 Without a clearly defined force development policy, overall personnel planning has been inadequate. In fact, there is no formally defined and comprehensive long-term personnel planning system in the Department, and no division or branch is specifically charged with the responsibility of developing such a system.

12.160 The lack of connection between force development and personnel planning has created a number of problems. These include: difficulties in defining or describing the overall personnel system leading to a lack of common understanding on the part of managers of how the system should work; systems that are suitable for peacetime but not particularly suitable for war; complex personnel manning and administration systems; and inconsistencies between personnel policies for the regular force and those for the reserves.

12.161 The Department is aware of these deficiencies and is working to resolve them. As discussed under the heading Planning, Control and Evaluation, the Department has initiated a Normative Planning project designed to determine and cost war and peace establishments.

12.162 **As a major component of the long-term force structure plan, the classification and trade structure for personnel should be appropriately redesigned**

and should ensure that manning policies and personnel policies generally are consistent with this overall structure.

> *DND response: This is a complex issue which requires extensive study. It is expected to be a requirement which will be fulfilled after approval of the structures produced as a result of Normative Planning.*

12.163 Responsibility for integrating the establishment design, manning policies and appropriate personnel policies to achieve the desired force structure should be clearly assigned to one official. A military personnel planning function should be established within the organization under this official's direction.

> *DND response: The Normative Planning Study now underway within the Department will, when approved, provide both a peace and war force structure. The design of systems to man this structure is the responsibility of the ADM (Personnel); the design of establishment and organization is the responsibility of the Chief of Program. The integration of these functions is the responsibility of the Vice Chief of the Defence Staff.*

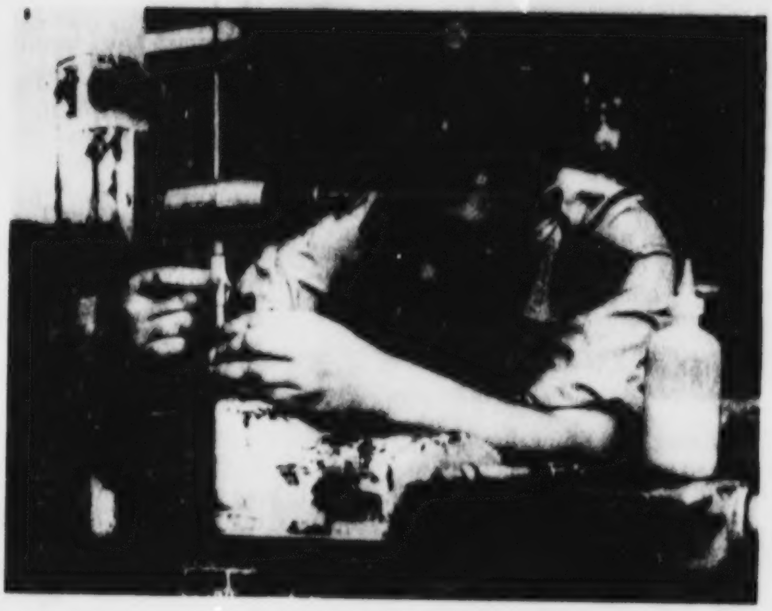
Military Training and Development

12.164 The Department's budget for military training in 1982-83 was set at $692 million. Approximately 15 per cent of Canadian Forces personnel are undergoing formal training at any one time.

12.165 In our 1982 Report, we reviewed planning and information systems related to military training and development. In this audit, we visited training facilities in each of the three environmental Commands. These were the Fleet Schools at Halifax and Esquimalt, the Armoured School in the Combat Training Centre at CFB Gagetown and basic fighter pilot training at CFB Cold Lake. We analysed each training facility in terms of:

- the existence and clarity of its objectives, goals and tasks;
- the degree to which it demonstrated due regard for economy and efficiency in the use of its resources and training activities; and
- training validation, which involves feedback to the trainers from the operational units that receive trainees.

12.166 We did not review collective military training or training other than the above.



Trainee taking machinist course, Canadian Forces Fleet School, Esquimalt.

12.167 **Responsibility and accountability.** Individual training needs for each facility are derived from operational needs as defined by a number of Headquarters advisory agencies, with input from the appropriate Command. The Command then carries out the needed training.

12.168 Training units do a creditable job of establishing priorities and allocating resources to tasks. However, the complex division of responsibilities for training between Commands and Headquarters makes it difficult for departmental management to be sure that the responsibilities assigned and resources allocated at the training facility level are consistent with operational objectives.

12.169 Operational commanders do not have control over the resources required for training activities delegated to them. Funding, training aids, operating costs and infrastructure are managed by various groups at Headquarters. Acquisition of staff, accommodation and materiel can take more than a year; minor equipment items such as overhead projectors have taken two years to acquire. Training units or schools are often given additional responsibilities without being relieved of other activities or given additional resources.

12.170 **The Department should establish mechanisms for reconciling individual training requirements with resources available for training.**

> *DND response: Departmental mechanisms exist and are effective in defining and prioritizing individual training requirements. The provision of resources to meet the training needs and additional responsibilities is not as well defined. Department-wide co-ordinating mechanisms exist in determining equipment and construction priorities but these are not directly related to the individual training requirements. The Department is examining the institution of a feedback system to better link field requirements and training output.*

12.171 **Training needs.** There are no formally established procedures to determine the extent or quality of training needed to meet operational requirements for the various classifications and trades. In general, experienced DND trainers had difficulty in interpreting training policies and procedures, but we noted that the Department is in the process of rewriting the training procedures manual.

12.172 **Costing**. Training needs related to major equipment acquisitions are not adequately costed. A DND report on individual training noted that the responsible managers seldom look beyond the acquisition stage to take into account life-cycle training needs. They appear to assume that downstream training costs will be absorbed by the system. The Department is now attempting to develop a training cost model for application to new equipment acquisitions. For recent acquisitions such as the CF-18 fighter aircraft and the Canadian Patrol Frigate, the Department has given increased attention to these areas, adding personnel and training staff to the project teams.

12.173 **The Department should assess the need for life-cycle cost and benefit analysis of training options related to major new equipment acquisitions.**

> *DND response: This is a recognized need and a new guide to Project Managers being produced will include an annex outlining the training support for new acquisitions. The document will task Project Managers to identify training costs at an early stage of development.*

12.174 **Training activities and equipment**. We found a high degree of ingenuity in the selection of training methods for the various courses taught. Extensive use is made of simulation techniques, and equipment is modified to increase training efficiency and effectiveness.

12.175 We observed that the condition of facilities, equipment and systems varied considerably among bases. In some cases, prevailing conditions did not provide a reasonable training environment. The Operations Tactical Trainer in Halifax, for example, was close to collapse, sonar facilities were obsolete and electronic warfare facilities were close to obsolescence. Some facilities operated at 150 per cent of anticipated capacity. At CFB Gagetown, toilet areas were used for storage, kitchen areas as television production control rooms, and vehicle hangars as classrooms. The regional utilization of Fleet Schools was unbalanced, with the East Coast school over-used and the West Coast school under-used.

12.176 Training specialists and training development officers who provide advice and leadership in training needs analysis, training concepts, design and management are not fully used or consistently employed across training facilities. New training technologies, such as self-paced and computer-assisted learning and instruction are also not used to the extent possible. In most cases, the initial expenses associated with these approaches prevent their introduction no matter what the overall cost saving might be. In our view, significant opportunities exist for the fuller use of these in the Canadian Forces.

12.177 **The Department should rationalize resource needs with training requirements and make fuller use of new training technologies.**

> *DND response:* *New training technologies are being considered. Many initiatives are being undertaken with regard to self-paced and computer-assisted learning techniques. There is a major development project on computer-assisted learning in the Program Development Proposal stage.*

12.178 **Validation.** As part of the follow-up to our 1982 audit of military training and development, which raised concerns with respect to validation, we reviewed the status of the Individual Training Study being conducted at that time. This study was commissioned in 1980 by the Chief of the Defence Staff as a result of concern about the cost and proliferation of training and its failure to meet objectives. The study report, issued in June 1982, addressed eight aspects of individual training, including validation. As of mid-1984, the disposition of these matters remained uncertain.

12.179 Although the report stated that "validation continued to be the missing link", no progress had been made by the Department to implement validation activities pending further study and cost-benefit analysis. We believe the Department should act on the study's observation to the effect that "at a time when personnel resources are at a premium, implementation of this final phase of the individual training system has the greatest potential, for the amount of resources required, to ensure that training is both effective and efficient".

Civilian Human Resource Planning

12.180 The Department has an approved civilian establishment of 35,653 positions, plus 4,000 term employees on strength. Total expenditures on civilian personnel are about $1 billion. More than 80 per cent of the civilian staff is employed outside of the National Capital Region.

12.181 There is no systematic forecasting of civilian requirements based on operational needs. For groups of employees that the Department considers to be "career managed", retirement and attrition projections are made and supply inventories kept. This, however, covers only 15 per cent of the Department's civilian population.

12.182 The size and composition of the civilian establishment is not determined in the light of current or future military requirements or to provide a continuity base to offset the effect of military rotations. The requirement for civilians, in quantitative and qualitative terms, has not been defined against current or future operational needs.

12.183 The Department should determine its civilian resource requirements in relation to the operational requirements of the military.

> *DND response: The basis for development of this requirement is in the Normative Planning Process. The Department will relate the peace and war structures into a more detailed definition for civilians.*

Civilian Training and Development

12.184 Over the past few years, the Department has made considerable progress toward improving its civilian training and development function. The Department has designed and introduced a civilian training and development system, the principles of which have been documented and promulgated in policy and procedures. Extensive regional pilot projects have been undertaken, leading to a phased implementation of the system on a national basis in 1983. Two fundamental aspects of the system were deferred because of limited resources – training managers to identify training and development needs, and validation of civilian training and development. Our findings indicate that there is considerable doubt that training needs identified by managers throughout the system are properly assessed and priorities established in relation to operational requirements. We were informed that these will be introduced in 1984-85.

12.185 The Department's budget for civilian training, which was set at $4.1 million for 1983-84, was determined without systematic identification of training needs and simply increased by an annual increment for 1984-85. Allocation of the budget is across the board and is not based on previously identified priorities for training. There is little co-ordination between civilian and military training, although civilians are expected to support military operations as part of an integrated work force.

12.186 The Department should ensure that managers are trained to identify civilian training needs, that these needs are assessed in relation to support for military operations and that appropriate priorities are established.

> *DND response: A recent departmental evaluation has addressed this shortcoming.*

Human Resource Information Systems

12.187 We reviewed three information systems designed to support military and civilian personnel management: the Automated Establishment Record, the Personnel Management Information System and the Automated Forecasting System.

12.188 The Automated Establishment Record system, which indicates to managers the approved establishment levels of various units, does not meet present needs, but we were informed that the Department plans to address this situation.

12.189 The Personnel Management Information System, which informs managers about the allocation of personnel to the various units, was developed about 15 years ago and has not kept pace with users' needs. The system has limited ability to extract and manipulate data and, because of its inaccuracy and untimeliness, many users maintain manual files. Also, the Department has found that the system would be inadequate under emergency circumstances. In 1982 we reported major problems with this system and recommended that it be redesigned. The Department indicated that this would be done by September 1984, but in mid-1984 no progress had been made. The Department's long-term Automatic Data Processing plan does not include a plan or timetable to redesign the system.

12.190 The Automated Forecasting System is used to provide projections on future peacetime establishments by military rank, and by military and civilian classification. It is an elementary management tool based on out-of-date automatic data processing procedures and it also does not meet users' needs. No plans are under way to update the system.

12.191 **The Department should establish a plan and schedule for improvements to its personnel management information systems for peace-time and wartime operations.**

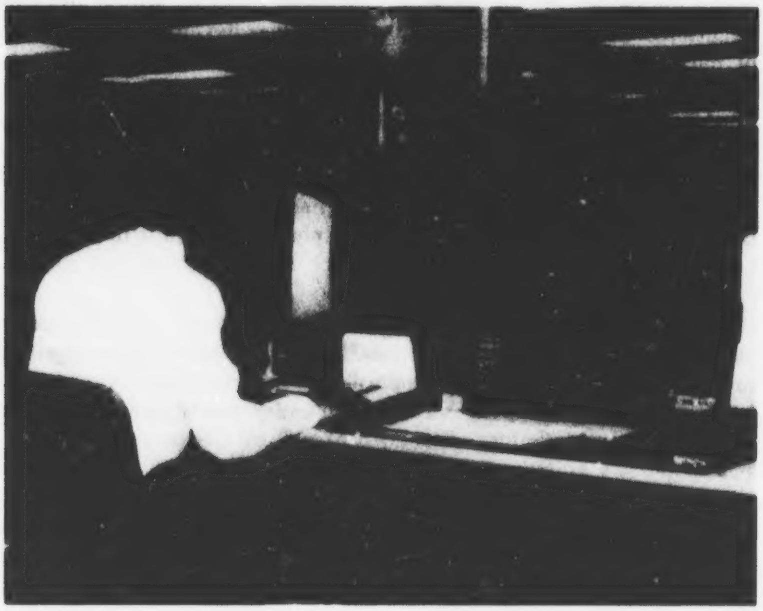
> *DND response: The DND 1984-85 long-term ADP Projects Schedule is published, but scarcity of resources has precluded earlier implementation.*

Automatic Data Processing

12.192 Automatic data processing (ADP) support is important in DND at all levels of the organization – National Headquarters, Command and base levels. According to the latest Treasury Board Review of EDP and Telecommunications, National Defence was third of 45 departments in terms of ADP expenditure and fifth in terms of ADP person-years. The Department estimated these resource expenditures at $76.7 million and 948 person-years respectively for 1983-84.

12.193 The Department operates two large, national-level data centres and many other facilities across Canada. A partial inventory, which does not account for all equipment in use, identified 227 computers with a total estimated value of $50 million.

12.194 Automatic data processing systems currently play a significant role in the Department. For example, the Canadian Forces Supply System controls an inventory estimated at $10 billion. Other systems track personnel, equipment and expenditures. ADP also contributes to research, education and intelligence gathering. Micro-computer usage is growing, as is the use of ADP technology in the area of command and control systems. Most important, however, adequate ADP systems would be critical to a successful transition from a peace-time to wartime footing.



Operations at Data Centre, Ottawa.

12.195 We reviewed only general purpose data processing, not tactical ADP systems such as computers embedded in weapons systems. We selected 13 application systems and followed them through the ADP life-cycle stages of system and equipment planning, acquisition and operation. Those that were in service were also reviewed for efficiency of operation and support to operational readiness.

12.196 In 1982, we reported that a new generation of ADP systems using current technology was required to meet the needs of the Department. This remains true today. We found that many of the major in-service ADP applications were not satisfying user needs or did not do so efficiently. This becomes significant if weaknesses or delays in the ADP management process or the departmental approval process prevent or delay replacement of such systems with newer, more efficient models.

12.197 The ADP management process would normally consist of planning to meet a determined need, system development, and in-service support. Department-wide planning for the application of ADP technology is fragmented and incomplete. The application development process is long, with major systems requiring several years to reach an in-service status. In particular, the final approval and funding for a major project can be very lengthy. Some important ADP monitoring and support processes either do not exist or are not yet fully activated. As a result of all these factors, older, inefficient systems will remain in service for some time. This is significant because it increases the cost and reduces the performance of systems in peacetime, and might restrict the support role of these systems in time of war or national emergency. Certain important systems would not be able to adequately serve the Department in an emergency situation.

12.198 Two major initiatives have been taken recently by the Department to improve strategic planning for ADP and enhance management control over applications already in service. A Strategic Planning Project and the System Management Process will address most weaknesses in planning and control, and are expected to implement specific improvements in 1984-85.

Strategic Planning for ADP

12.199 DND is a large, complex department for which ADP is an important management tool. Many management and operational functions depend on automated data handling, and this sort of dependency is expected to increase. The need for accurate, secure and readily available information increases dramatically in an emergency situation. The trend to dependence on data processing is common to most NATO countries. If Canada did not keep pace, operational communication with allies would be severely restricted.

12.200 Defining ADP requirements and priorities forces an organization to develop a strategic framework – normally an ADP planning policy, a published and current strategy and an up-to-date long-range plan. Although the Department, consistent with stated policy, is moving on several fronts toward distribution of ADP capability and systems, there is little current documentary evidence of a strategy controlling this movement. Many different plans exist covering different scopes, timeframes, and degrees of detail, but a long-range plan outlining the strategic ADP needs of the Department does not exist. There has, however, been some progress since our 1982 audit: the new National Level Facilities Plan deals comprehensively with both computer equipment and the impact of decentralization at the national level.

12.201 Despite these recent improvements, ADP plans continue to be incomplete. ADP planning in the Commands varies in scope and direction and is not always reflected in Headquarters planning. Furthermore, some projects do not appear in any current ADP plans. To improve the handling of spare parts, for example, the Department is dealing with bar-code recognition similar to that found in supermarkets. This project was initiated to specifically respond to a weapons system requirement. As such it is classified as a weapon system support activity and, as a trial project, was granted an exemption from the annual submission by Treasury Board. Although this meets general Treasury Board guidelines, the use of general purpose computing equipment and the possible effect on other departmental systems suggests that internal planning documents should cover projects such as these.

12.202 Not having a departmental ADP framework linked to an overall force structure means that the way ADP is to support operational readiness is ill-defined. The Department's ADP policy states that ADP shall be used to enhance the Department's capability to perform its commitments in time of war or national emergency. Detailed information requirements are under continuing study at the various Command levels. However, a formal framework relating information systems to roles and tasks is not yet readily identifiable.

12.203 The Department has recently produced a draft planning methodology as a result of the Strategic Planning Project. While a preliminary draft of a strategic systems plan is anticipated in early 1985, it will take some time before the procedure settles down.

12.204 **The Department should further investigate the role of ADP in relation to its Departmental Force Structure plan, decide on an ADP strategy, publish long-range plans and assign responsibility for the management, review and updating of both strategy and plans.**

> DND response: *These activities are being co-ordinated between NDHQ and Commands. The evolution towards an environment where information systems will be strategically important components of the Department's infrastructure essential to mission accomplishment is recognized. This linkage led to the initiation of the Informatics Strategic Planning Process in August 1983. The output of this process should, inter alia, provide an ADP Strategic Plan which would be reflected in the DSP, the Capital Plan, the Multi-Year Operational Plan and the Strategic Defence Services Program Overview, as warranted.*

System Development

12.205 We examined the way decisions are made within the Department to approve and fund ADP projects through the Defence Program Management System. We found that the process was complex and cumbersome, and that decisions are made piecemeal, project by project, in the absence of an overall ADP strategic plan and a comprehensive short-term ADP action plan. The decision process is also very slow: the final approval and funding for an important project can take years. One project was reclassified, and thus removed from the ADP environment, because of the realization that it was more integral to a weapon system than originally envisaged but also as a result of delays in the approval and funding necessary to deliver the original system as requested. There may be a tendency to alter the effect of the process by describing projects having substantial ADP content in such a way that they fall outside the ADP area. If this is done, the Department's ADP planning ceases to be comprehensive, and the management of ADP as a resource must suffer. We believe the situation could be improved if the decision process rested on firmly established ADP plans.

12.206 **The Department should develop a short-term automatic data processing plan within the framework established by a long-term ADP plan, which would provide a work schedule for project activity that could be used as a basis for management decisions at many levels.**

DND response: The need for short-term plans to relate to and be consistent with long-term plans is recognized. The existing Three-Year Work Plan will be revised to harmonize with the ADP Strategic Plan, once this is produced.

12.207 In attempting to gain firmer control of the process of developing ADP systems and monitoring their progress through the life cycle, DND is encountering the kind of problems we described in the chapter on the Management of Computing in our 1983 Report. We found that the level of detail provided in cost estimates varied greatly among projects reviewed and that a thorough cost-benefit analysis was not always carried out. DND has not laid down what information about an ADP project should be recorded as the project goes along, to guide project managers and allow senior management to monitor progress. Most major ADP development projects in DND are forecast to last five years or longer and have identified funding requirements in the millions of dollars. For projects of this magnitude, complete and accurate cost and schedule information is very important. This is not always readily available or comparable, nor are post-implementation reviews regularly carried out.

12.208 The Department should ensure that detailed cost estimates are made and that appropriate cost benefit studies are carried out for each project. Guidelines should be produced to define project status reporting requirements. A post-implementation review methodology should be implemented.

DND response: This recommendation is agreed. Processes to achieve these capabilities are under active review. This recommendation is further related to the recommendations relating to the acquisition stage for Major Equipment Projects.

Management Control

12.209 Most of the Department's major application systems were designed years ago and reflect a technology now obsolescent. Moreover, the needs of users have changed, with the result that there is now a high volume of requests for system modification. The age of the applications makes modifications time consuming and difficult to carry out. For example, the Supply System is now nine years old, uses a staff of 30 programmers and has 150 backlogged change requests. This has resulted in large measure from an environment of resource constraint and the fact that ADP projects must compete with all other capital projects for scarce resources. There is no formal process for determining the cost and operational effect of maintaining these older systems in service, although studies of individual systems have been reported to management and a program of user evaluation of systems is now under way. These studies suggest that costs may be high and adverse effects on ADP operations may be significant.

12.210 Although the Ottawa Data Centre was intended to have enough surplus capacity to provide backup for the Borden Data Centre, the load on the Ottawa computer is now so large that its backup role is no longer credible. Even operating around the clock, seven days a week, the Ottawa Centre is having trouble carrying its own workload. One of the effects is that programmers get slow turnaround for development work. This situation is further complicated by the fact that the Department can provide only one terminal for every four programmers because the Centre lacks the capacity to handle more terminals. A proposal has been submitted to Treasury Board to expand the Ottawa Data Centre to address these deficiencies as part of the primary justification.

12.211 The Borden facility is primarily dedicated to running the Canadian Forces Supply System. As the result of a capacity crisis in 1982, the computer was replaced. The under-capacity had been predicted as early as 1976 but the resources and management approval to correct it were not provided until six years later. However, until the new Supply system is implemented, the Department must retain in service the old terminals now used in the field to access the system or run new terminals duplicating the operation of the old equipment. For this reason the old operating system, which has been heavily modified and requires highly skilled specialists to maintain it, had to be placed on the new larger computer. It may also be constraining the efficiency of the new machine in which it is installed. The Department is working to improve this situation prior to the implementation of the new Supply System.

12.212 It is difficult to determine whether these capacity problems are attributable to the Department's failure to plan for its computer needs or are simply related to resource problems. It is clear, however, that the Department currently lacks an ongoing process for performance monitoring and planning the capacity of its facilities that feeds ADP planning. The System Management Process will address this concern as part of a broad program to upgrade the management system structure surrounding the operation of national level applications.

12.213 The Department should monitor the performance of its computer facilities and systems on an ongoing basis, and use this information in the ADP planning process.

> *DND response: This recommendation is agreed. This is one of the primary reasons for the ADP Systems Management Process, for which the OAG staff have been provided full details, and which they have fully supported.*

12.214 Financial control. Detailed data on costs to develop, maintain and operate ADP application systems are essential, both for estimating the cost of new systems proposed for development and for measuring the cost-effectiveness of existing ADP applications and facilities. Such data are not systematically collected.

12.215 Lifetime cost data should be accumulated on each major application and used in the planning and performance measurement process.

> *DND response: This recommendation is agreed. While full detail has not been available in the past, considerable data has been collected regarding direct costs. Its use in subsequent planning processes has been limited.*

12.216 **Disaster recovery at the national level.** The equipment recently acquired to upgrade the Borden Data Centre has given it the extra mainframe capacity needed to handle the mobilization and potential wartime work loads of the Canadian Forces Supply System. It has also resulted in some incompatibility with the computer in Ottawa, seriously limiting the Ottawa Centre's capability to provide backup. In a crisis, the Supply System would demand more capacity than the Ottawa Centre has available. There are no current contingency plans for the Ottawa Centre to back up the Centre in Borden although it is accepted practice in the ADP industry that significant systems should have formal backup arrangements. Interim recovery procedures exist in response to DND's Survivability Policy. The proposal to expand the Ottawa Centre is intended to allow that facility to provide a backup capability for applications run at Borden.

12.217 **All major facilities operating systems identified as critical should have formal survivability and disaster recovery arrangements.**

> *DND response: The need for survivability plans has been recognized for some time. It was formalized in the ADP Survivability Policy approved in June 1983. The Survivability Plan now under way will further assist in establishing major discreet guidelines and procedures for the implementation of that policy.*

Financial Administration

12.218 The Department manages a $9 billion annual budget through a combination of committees and various other organizational arrangements, management information systems, and a myriad of regulations, orders, directives and manuals. Delegation of authority is achieved through a wide range of directives, signing authorities, position schedules and orders.

12.219 The system of annual funds apportionment, allotment and accounting focuses on ensuring that expenditures and revenues are appropriately recorded, funds are spent within financial authority, and budgets are controlled. These important aspects of financial administration work satisfactorily in National Defence.

12.220 We have identified areas for improvement in clarifying and strengthening the role of the Senior Financial Officer as well as relating planned and actual resource consumption with operating plans and results. These have been discussed with the departmental personnel concerned.

DEPARTMENT OF PUBLIC WORKS

DEPARTMENT OF PUBLIC WORKS

Table of Contents

	Paragraph	Page
Overview	13.1	13–1
Audit Scope	13.10	13–4
Observations and Recommendations		
Accommodation Program	13.12	13–5
Leasing	13.13	13–5
Case Studies	13.32	13–11
Lease-purchase Arrangements	13.42	13–17
Case Studies	13.55	13–21
Management of Space	13.65	13–23
Energy Conservation	13.97	13–30
The Budgetary Process	13.103	13–31
IMPAC/Revenue Dependency	13.127	13–34
Marine Program	13.147	13–38
Dry Dock Operations	13.149	13–38
Dredging Operations	13.158	13–42
Professional and Technical Services Program		
Architectural and Engineering Services	13.162	13–42
Audit and Evaluation		
Management Audit	13.186	13–46
Program Evaluation	13.190	13–46
Department's Response		13–47
Exhibits		
13.1 Summary Organization Chart		13–2
13.2 Summary of Expenditures and Person-year Utilization by Program		13–3
13.3 Inventory of Space and Buildings by Region		13–6
13.4 Summary of Cases of Lack of Due Regard to Economy/Additional Costs to the Crown		13–8
13.5 Existing Major Lease-purchase Arrangements with Continuing Payments		13–16
13.6 Analysis of Financing Costs of Four Recent Lease-purchase Arrangements: Financing through Developer versus Financing by Crown		13–20
13.7 Total Expenditures (Capital and Operating) and Revenues -Esquimalt Graving Dock and Lauzon Dry Docks 1977-78 to 1983-84		13–40

13

DEPARTMENT OF PUBLIC WORKS

Overview

13.1 Exhibit 13.1 shows a summary organization chart. In 1983-84, the Department's expenditures totalled approximately $1,899 million, and it had 8,761 person-years (Exhibit 13.2).

13.2 **Payments to Crown corporations**. The Department's 1983-84 expenditures include $101 million for payments to the following Crown corporations, whose operations were not included in the scope of our review, for management, development and construction services:

- Canada Lands Company (Le Vieux-Port de Montréal) Limited;
- Canada Lands Company (Vieux-Port de Québec) Inc.;
- Canada Lands Company (Mirabel) Limited;
- Canada Harbour Place Corporation;
- Canada Museums Construction Corporation Inc.; and
- Harbourfront Corporation.

The first five corporations are subsidiaries of the Canada Lands Company Limited.

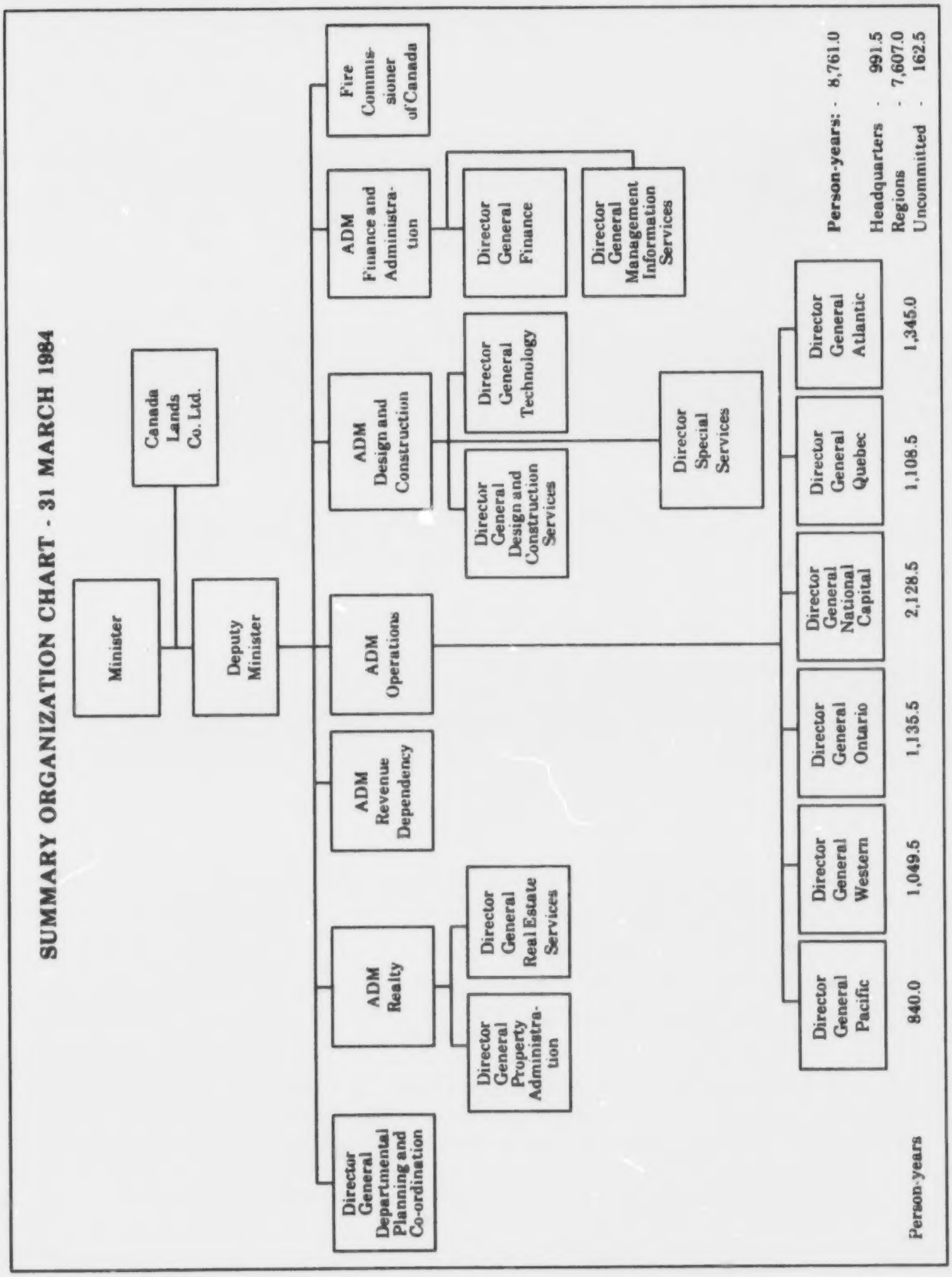
13.3 These corporations have the mandate to manage and develop large and diversified holdings in the Department's inventory and are responsible for planning, organizing and managing their own operations. They report direct to the Minister of Public Works, except for Canada Harbour Place, which reports to the Minister of Transport, and Canada Museums Construction, which reports to the Minister of Communications.

13.4 Since our 1979 comprehensive audit, the following significant events have affected the operations of the Department.

13.5 **Revenue dependency**. In January 1981, the Department obtained qualified approval in principle for its proposal to charge other government departments for accommodation and realty services. This will fundamentally change not only the existing basis of funding but also the current mode of DPW's operations and landlord-client relationship. Present plans call for implementation of revenue dependency in 1986.

Exhibit 13.1

SUMMARY ORGANIZATION CHART - 31 MARCH 1984


Minister
Canada Lands Co. Ltd.
Deputy Minister
Director General Departmental Planning and Co-ordination
ADM Realty
Director General Property Administration
Director General Real Estate Services
ADM Revenue Dependency
ADM Operations
ADM Design and Construction
Director General Design and Construction Services
Director General Technology
Director Special Services
ADM Finance and Administration
Director General Finance
Director General Management Information Services
Fire Commissioner of Canada
Director General Pacific
Director General Western
Director General Ontario
Director General National Capital
Director General Quebec
Director General Atlantic
Person-years
840.0
1,049.5
1,135.5
2,128.5
1,108.5
1,345.0

Person-years: - 8,761.0

Headquarters - 991.5
Regions - 7,607.0
Uncommitted - 162.5

13.6 **The Canada Post Corporation.** In October 1981, Parliament approved the establishment of the Canada Post Corporation. The Corporation has assumed ownership of post offices, mail terminals, and other facilities which had been built and managed by DPW since Confederation.

13.7 This has affected some 2,200 Crown-owned buildings having an approximate market value of $1.4 billion and more than 800 leased premises whose annual rental payments amount to some $28 million. They represent approximately 20 per cent of the DPW inventory of space. Currently, the Department is managing these facilities on behalf of the Corporation on a cost-recovery basis. Negotiations about the future relationship between the Corporation and the Department are under way.

13.8 **Common services policy.** In September 1982, Treasury Board issued its policy on common services, naming DPW as the common service organization responsible for accommodation, design and construction services and stating that the primary goal of common service organizations is to attain maximum value for money. Treasury Board continues to have the responsibility of issuing general directives and guidelines on the acquisition, use, and disposal of real property materiel and services.

13.9 **Marine Program funding**. The almost total responsibility for dredging operations held by DPW for many years was progressively reduced during the last decade as a result of Marine Program transfers – the first to Fisheries and Oceans for Small Craft Harbours in 1973, and the remainder to Transport in April 1982. DPW has retained responsibility for funding the Department-owned and operated Dredging and Fleet Services and, acting as a common service agency, is now required to provide dredging, construction and other professional and technical services for its clients, the Department of Transport and the Department of Fisheries and Oceans.

Audit Scope

13.10 Our audit focused on determining whether the Department's activities were being carried out with due regard to economy and efficiency. Our examination concentrated on the Accommodation Program but extended to all the programs of the Department except the Municipal Grants and the Transportation and Other Engineering Programs. Findings relating to capital acquisitions, management of real property and the Land Management and Development Program are reported in the government-wide study of Real Property in Chapter 6.

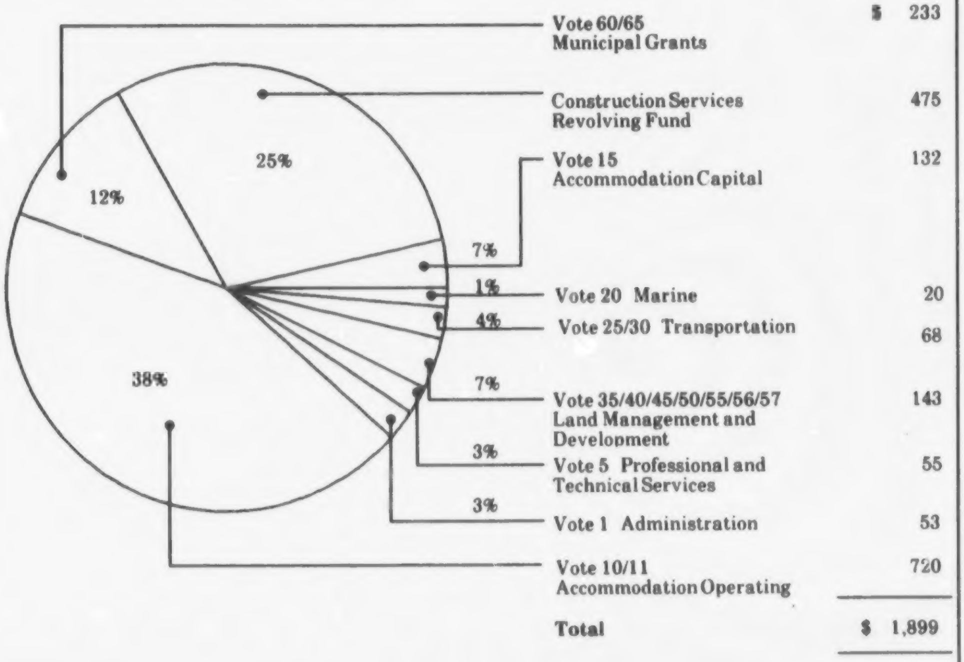
13.11 In 1983, the Government announced the Special Recovery Capital Projects Program under which DPW will be responsible for construction projects totalling approximately $690 million. Because the projects under the program were either in the planning or early implementation stage at the time of our audit, they were not included in the scope of our examination.

Exhibit 13.2

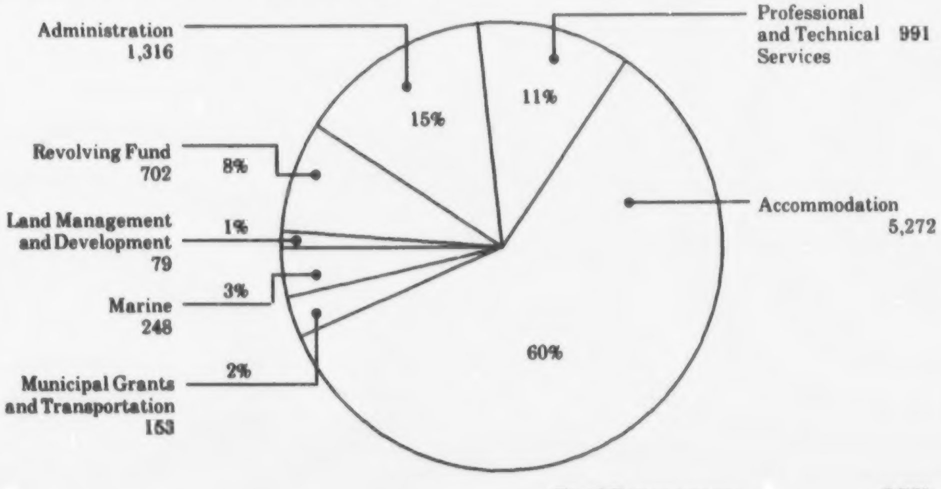
DEPARTMENT OF PUBLIC WORKS
1983-84

Summary of Expenditures by Program

(Dollars in Millions)



Person-year Utilization by Program



Total Person-years 8,761

Observations and Recommendations

Accommodation Program

13.12 The Department provides accommodation to federal departments and agencies through leasing, lease-purchase and construction. This section contains our principal findings and recommendations relating to leasing, lease-purchase arrangements, the management of space, energy conservation, and the budgetary process for Crown-owned facilities. Our observations relating to Crown construction and real property management are reported in Chapter 6.

Leasing

13.13 Under the Common Services policy, Treasury Board has directed that departments shall use DPW as their agent for renting office accommodation within Canada from the private sector. In effect, the Department is required to act as an agent of Treasury Board in acquiring accommodation; it can only act on requests from departments and agencies when such requests have the necessary approvals and comply with Treasury Board's policy.

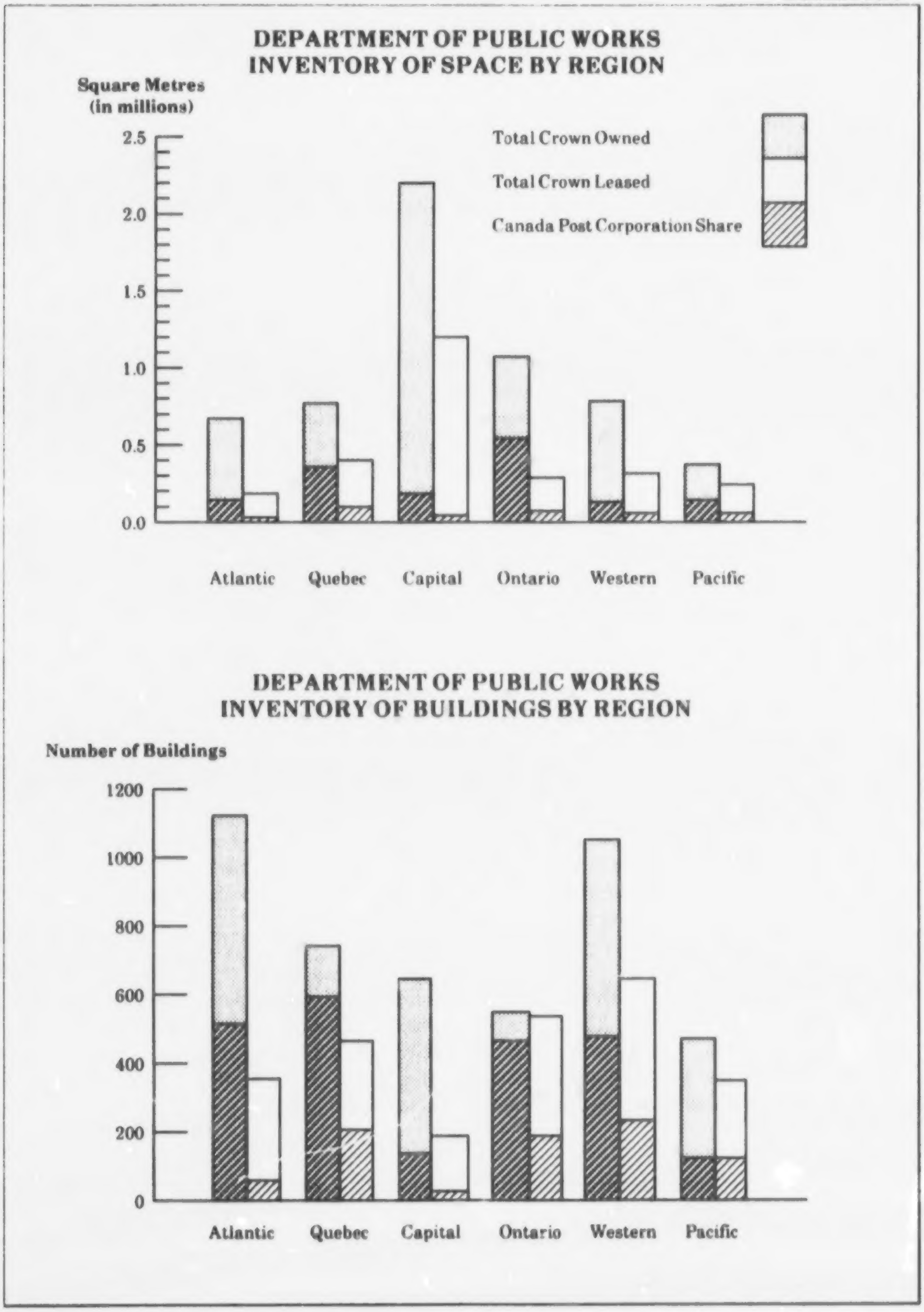
13.14 The Department manages a lease and lease-purchase portfolio of over 2,500 premises with a total rentable area of approximately 2.7 million square metres (Exhibit 13.3). Total annual payments for this space exceed $270 million. The National Capital Region accounts for about 45 per cent of the leased space and 42 per cent of the lease payments.

13.15 In 1978, the Senate Committee that examined the Accommodation Program reported that, "the Department of Public Works has difficulty in preparing its five-year forecasts because it is not informed about the accommodation implications of programs being planned by client departments until they reach an advanced stage of development. This is a continuing and hard problem to solve." The problem still persists, though lessened by both increased contacts with client departments and the Government's Policy and Expenditure Management System.

13.16 In providing accommodation, the Department must respond quickly to broad policy decisions taken by the Cabinet or the Treasury Board about the public service. Redistributing public service jobs between Ottawa and Hull and moving federal public service activities out of the National Capital Region to decentralize government have influenced DPW planning and management of space requirements.

13.17 In testimony before the Public Accounts Committee in February 1984, the Deputy Secretary of the Administrative Policy Branch of Treasury Board stated that "... the accommodation of the public service in Ottawa and Hull, the National Capital Region, is a gigantic jigsaw puzzle and there are always new priorities emerging and old priorities falling by the wayside. It is an enormous problem." For example, in April 1982, the

Exhibit 13.3



DEPARTMENT OF PUBLIC WORKS
INVENTORY OF SPACE BY REGION

DEPARTMENT OF PUBLIC WORKS
INVENTORY OF BUILDINGS BY REGION

Department acquired a parcel of land in downtown Ottawa for $9.7 million from the National Capital Commission with the intention of constructing a building to accommodate the Department of Finance, Treasury Board and the Office of the Comptroller General. Because of changing government priorities the building was never constructed; the land is currently being used as a parking lot.

Aerial view of downtown Ottawa.

13.18 These entities are currently being accommodated in premises for which the lease expires in November 1984. The landlords have informed the Department that the building is required for their own use and the Crown must vacate. As a result, the entities are to be moved into a building occupied by a number of other government departments which must be located elsewhere. The Department estimates that the total costs for fit-ups and moving could amount to approximately $22.9 million.

13.19 There are many directives and policies designed to guide leasing activities and to ensure due regard to economy and efficiency. The broad principles for acquiring and managing real property are contained in the Treasury Board Administrative Policy Manual, which was prepared in consultation with DPW and other federal departments as well as the private sector. The Department also has a number of its own manuals which contain detailed policies and procedures for all its activities.

13.20 We found, however, that even considering the difficulties involved, the Department's leasing activities were not always managed in accordance with Treasury Board's and the Department's own directives and policies, especially in the National Capital Region. This is not because of a lack of policies and directives but because there appears to

Exhibit 13.4

SUMMARY OF CASES OF LACK OF DUE REGARD TO ECONOMY/ADDITIONAL COSTS TO THE CROWN

Leased Premises	Main Causes	Unproductive Rental Payment	Additional Costs to the Crown	Other Payments Made	Total Additional Costs to the Crown
			(dollars in thousands)		
Place de Ville Tower C and Podium, Ottawa	Failure to disclose essential information to Treasury Board and to negotiate a lease in a timely manner.		42,709		42,709
Centennial Towers, Ottawa	Acquisition based on "perceived urgent need" of an agency and subsequent reallocation of leased premises to another client department whose need was not urgent.	4,384			4,384
Bourque Memorial Building, Ottawa	Landlord claimed delays in upgrading of building based on construction schedule and occupancy dates established by DPW.	998		444	1,442
Sir Wilfrid Laurier Building, Ottawa	Compensation for delay of occupancy, and extra payment for upgrading elevator.	1,616	5,214	210	7,040
Canadian Building, Ottawa	Compensation for delay in instructing lessor to proceed with upgrading work, and payment to lessor to renovate building at $1,360,000.		2,639	1,360	3,999
Lord Elgin Plaza, Ottawa	Acquisition of space not based on detailed statement of requirement. Delay in fit-up work.	433			433
Cross Canada Flights, Ottawa	Failure to react promptly to lease offer.		265		265
360 Coventry Road, Ottawa	Additional fit-up costs due to inadequate estimating procedures and cost overrun.			136	136
Place Jacques Cartier, Quebec City	Failure to acquire least cost accommodation based on tender evaluation.		1,355		1,355
	One-year extension option exercised in another leased premises to accommodate another client department partly due to delay in occupancy at Place Jacques Cartier.		283		283
108th Street Building, Edmonton	Failure to exercise renewal option promptly.		253		253
Executive Terrace, Regina	Failure to select acceptable offer in response to tender call.		294		294
1133 Melville Street, Vancouver	Unproductive rental payments due to delay in obtaining authority to increase fit-up costs.	529			529
	TOTAL	$7,960	$53,012	$2,150	$63,122

be no effective mechanism to ensure that the Department and its client departments and agencies comply with them. There were many instances of such non-compliance; we noted several leasing transactions which were carried out without due regard to economy or proper authority. Additional costs to the Crown from the transactions we reviewed amounted to approximately $63 million over the duration of the leases (See Exhibit 13.4).

13.21 In 1982, the Department leased a 54,000 square metre building for 10 years at a cost of $154 million without obtaining authority from Treasury Board as required by Government Contracts Regulations. Such authority was only obtained on 30 August 1984.

13.22 **Definition of requirement**. We noted that client departments frequently did not clearly state their requirements as directed by Treasury Board. In addition, the Department did not always satisfy itself that all the necessary information was provided to permit a judicious real property acquisition before commencing action on client requests. This fact was also noted by the Public Accounts Committee in its Report issued in April 1984, following hearings into the acquisition of Centennial Towers in Ottawa.

13.23 **Real property acquisition decisions**. Departmental policies and procedures relating to the project approval process require a project memorandum and project feasibility report to be prepared for lease projects with expenditures over $30,000 annually or a three-year term or more. The purpose of these reports is to define project requirements, provide detailed quantitative and qualitative data and establish a comprehensive project plan and time schedule. We noted 14 instances, 10 in the National Capital Region, where such reports were not prepared before a lease decision was made. Without them, it is impossible for management to ensure that all valid options are considered and proper analyses are done before an acquisition decision is made.

13.24 **Acquisition process**. The Administrative Policy Manual states that tenders shall be invited for lease of accommodation in excess of 250 square metres, with certain exceptions. In August 1980, Treasury Board directed the Department to ensure that all lease proposals, for both new and renewed leases, were tendered publicly. Subsequently, in November 1980, Treasury Board approved new policy provisions for inclusion in the Administrative Policy Manual, setting out three situations in which departments need not obtain Treasury Board approval to bypass the tendering process for leases of accommodation in excess of 250 square metres. These were, first, where the need is one of pressing emergency in which delay would be injurious to the public interest, second, where the nature of the work is such that it would not be in the public interest to invite tenders, and third, where only one person is capable of performing the contract. However, Treasury Board stated that the intention of the policy was that the maximum number of tenders be invited for leases by advertising in one or more newspapers.

13.25 In 1983, Treasury Board noted that tenders were called for an extremely low percentage (7 per cent) of leases entered into in 1982. We observed that the Department, for the year ending 31 December 1983, had entered into lease arrangements through public tenders only 74 times in negotiating 1,204 new and renewed leases (6 per cent). In some cases there is justification for bypassing the tendering process. However, in our opinion, because of the frequency of bypassing the competitive tendering rules by the Department, there is no guarantee that departments and agencies are being accommodated in buildings of acceptable quality at the lowest possible cost. In addition, it is doubtful that the Government's policy of fairness in spending public funds is being followed.

13.26 In tendering for a large amount of office space in the National Capital Region in 1982, the Department issued a Lease Tender Call giving specific requirements for eight lease renewals. However, this document also contained a blanket invitation for "any quantities and combinations of office, storage and parking spaces. Proposals could be for existing or proposed buildings...." In response to this, the Department received 32 acceptable proposals and entered into a number of leases in addition to those for the eight specific requirements, including the lease on Centennial Towers. In our opinion, this blanket proposal does not comply with the letter or spirit of Treasury Board directives for the competitive tendering process which direct that requirements should be clearly stated.

13.27 Bids received by the Department in response to its tender calls for office accommodation are analysed using a Quality Index Point Score Rating System. Our review showed that this system is greatly weighted in favour of qualitative factors and could result in the acquisition of more expensive space even though cheaper space of acceptable quality was available.

13.28 The Department states that it does not always want the lowest possible cost lease, but tries to ensure a Treasury Board approved "best value approach". In our opinion, this approach is not consistent with the Government's policy of providing departments with accommodation of the required size and of a quality that meets established standards at the lowest cost.

13.29 **Approval process**. Treasury Board authority is required to enter into a lease where total annual rental payments exceed $200,000. In addition, Treasury Board approval is required when the overall interest of the Government can best be met by a central review of a procurement action with respect to contracting risks or its effect on related government programs. In August 1980, Treasury Board expressed concern to the Department about the number of leases being presented for retroactive approval and the fact that none of them had been given public exposure. During the current audit we noted seven additional instances since 1980, with total annual rentals of $8 million, where Treasury Board approval was not obtained until after the lease commencement date. The Department entered into three other leases without Treasury Board authority; the total annual rental payments under these three leases amount to $14 million.

13.30 **Fit-up cost guidelines**. The current fit-up cost limits were established by Treasury Board in 1977 at $82.85 a square metre for new office space. The Department has stated that fit-up costs have increased since 1977 by about 56 per cent, and Treasury Board Secretariat officials agree that current fit-up cost should probably be around $120 a square metre. However, Treasury Board has not taken any action to revise the fit-up cost guidelines, and the Department is required to obtain Treasury Board approval every time it has to exceed the limits. Preparation and approval of Treasury Board submissions often require a lot of time and resources, and the resulting delays in move-in schedules cause unproductive rental payments.

13.31 **The Department of Public Works should comply with Treasury Board and departmental directives and policies, and should request Treasury Board to review its current fit-up cost guidelines.**

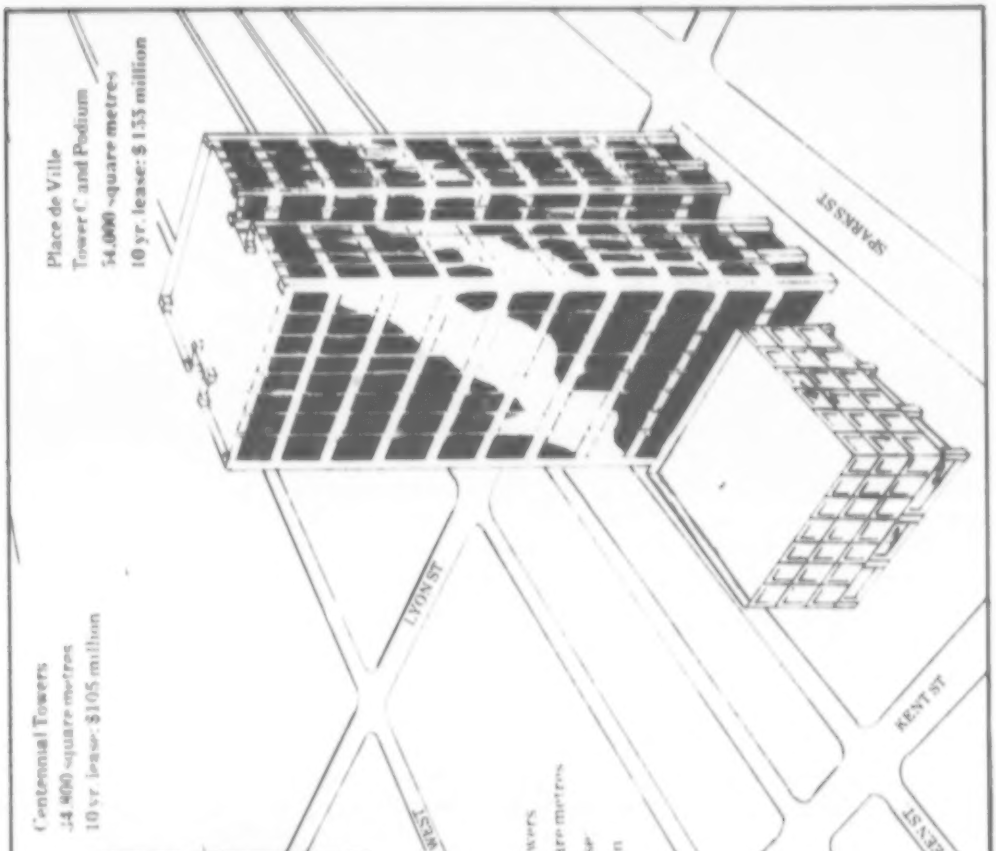
Case Studies

13.32 **Place de Ville Tower C (including Podium), Centennial Towers, and Journal Towers, Ottawa**. These three buildings, located in downtown Ottawa, were leased from the same landlord in 1982-83 for 10 to 10.5 years for a total of about $400 million. We found that, in arranging these long-term leases, the Department did not disclose essential information to the Ministers of the Treasury Board, entered into direct negotiations with the landlord without public tender, failed to negotiate in a timely manner, and acted beyond its authority by not obtaining necessary approvals from Treasury Board. As a result, the Department leased the accommodation on unfavourable terms that resulted in the following:

- **Place de Ville Tower C**: additional costs to the Crown of $42.7 million over the 10-year term of the lease.
- **Centennial Towers**: loss of the opportunity to acquire the building through lease-purchase for only $15 million more than the present value of the total 10-year lease payments. In 1981, the Department estimated the value of this building to be $46.5 million.
- **Journal Tower South**: a rental rate of approximately $72 a square metre more than the rate charged by DPW to client departments and as appraised by an independent firm on request from the Department. For 22,500 square metres of space, this amounts to a difference of approximately $8 million that the Department would have to absorb over the first five years of the lease should it operate on a cost-recovery basis.
- **Journal Towers North and South**: leases for the two buildings for a term of 10.5 years for a total cost of $135 million were entered into without public tender. The Department in March 1982 informed Treasury Board that no alternative space was available to meet the requirement. We noted that the requirements for the 11 unrelated occupants of the Tower South ranged from 303 square metres to a maximum of 6,794 square metres. The Department at that time had 18,000 square metres of Crown-owned office space in Place du Portage Phase IV, Hull, which had been vacant since May 1978. In addition, in response to a tender call issued by the Department later that year, 32 acceptable offers for space were received.

13.33 The following is a chronology of events in the negotiations:

MAJOR OFFICE BUILDINGS IN DOWNTOWN OTTAWA LEASED WITHOUT DUE REGARD FOR ECONOMY


Place de Ville
Tower C and Podium
54,000 square metres
10 yr. lease: $133 million
Centennial Towers
34,900 square metres
10 yr. lease: $105 million
Journal Towers
48,500 square metres
10.5 yr. lease
$135 million
SPARKS ST
LYON ST
KENT ST
QUEEN ST
ALBERT ST
SLATER ST
LAURIER ST. WEST

Note: Amounts based on actual lease

15 April 1981	The Department suggested to the landlord that leases for two of the buildings – Place de Ville Tower C (54,000 square metres) and Centennial Towers (34,800 square metres) – be negotiated as a package deal.
19 May 1981	The National Capital Region Office of DPW was directed by Headquarters to begin negotiations for a package deal. Headquarters did not deem prior permission of the Treasury Board necessary.
	Treasury Board Secretariat was informed that no suitable alternative accommodation was available and therefore the Department would negotiate with the owner; the leases for the two buildings would be negotiated simultaneously.
26 June 1981	Treasury Board Secretariat expressed surprise that the negotiations were commencing at such a late stage. (The renewal date was 1 November 1981.) Because of the limited available options, the Secretariat believed there was no merit in approaching the Ministers of the Treasury Board at this time.
12 August 1981	The landlord made a written offer to lease office space at Tower C to DPW for 10 years at $190 per square metre (about $103 million over 10 years). The offer, which was valid until 30 September 1981, made no mention of any package deals. DPW preferred the establishment of two rental rates for two 5-year periods rather than an annual 10-year rate, and therefore did not accept the offer.
11 December 1981	Following negotiations for a package deal, the Department prepared two separate submissions for the buildings, neither of which made any mention of a package deal. The Department indicated that it had negotiated to rent office space in Tower C at about $112 million over a 10-year term. Centennial Towers was to be acquired by a lease-purchase arrangement having a present value at that time of $61.5 million.
28 January 1982	Treasury Board approved the Department's proposal for Tower C but rejected the lease-purchase for Centennial Towers, and directed the Department to call for public tenders.
29 January 1982	The Department issued a letter of acceptance to the landlord for Tower C.
1 February 1982	The landlord stated that the approval of Tower C alone was totally unacceptable and withdrew the offer.
5 February 1982	The Department of Justice stated that evidence showed that the landlord had negotiated the transaction as a package deal and the Crown could not now argue otherwise.

8/10 February 1982	Treasury Board reconsidered the two submissions, and the President of the Treasury Board directed the Department to clarify the landlord's offer for a separate lease for Tower C and to prepare a new submission. This was done only on 28 August 1984. The Board noted that until then it had been led to believe that the two deals had been negotiated separately by the Department, leading it to the conclusion that either of them could be dealt with on its own merits.
11 February 1982	In spite of this direction, the Department issued a letter accepting the landlord's revised offer for office space in Tower C, which increased the rental from the original offer of $112 million to $154 million for a 10-year term.
31 March 1982	The Department's submission to Treasury Board relating to renewal without tender of the leases for the Journal Towers (North and South) indicated that the landlord considered his offer for Place de Ville Tower C to be conditional on approval of his proposal to renew the leases on the two Journal Towers. (To date, the Department has been unable to provide us with documentation to support this.) The existing leases for the Journal Tower North were not due to expire until 30 April 1983.
8 April 1982	Treasury Board approved 10.5-year leases for the two Journal Towers for a total cost of $142.5 million.
14 July 1982	DPW entered into a 10-year lease for Tower C effective 1 November 1981 for a total occupancy cost of $155 million.
29 June 1983	Treasury Board approved a 10-year lease for Centennial Towers for a total payment of about $120 million. In 1983 we reported to Parliament that this lease had been entered into without due regard to economy, a position later supported by the Public Accounts Committee.
30 August 1984	Treasury Board approved the Department's submission to ratify the lease entered into on 14 July 1982.

13.34 **Lack of key documentation.** Our examination revealed the following deficiencies:

- The Department could not provide us with a copy of the landlord's offer to rent Tower C that corresponded to the rental rates (about $112 million over 10 years for office space) and other conditions included in the 11 December 1981 submission approved by Treasury Board.
- The Department advised us that it had informed Treasury Board that leases for the two buildings, Tower C and Centennial Towers, had been negotiated as a

package deal. However, DPW has been unable to produce documentary evidence indicating that Treasury Board received the above information prior to 28 January 1982, the date on which it decided on the proposal for Tower C.

- The Department's submission of 31 March 1982 to Treasury Board stated that the landlord considered his acceptance of the offer for Tower C to be conditional on the acceptance of his proposal for Journal Towers North and South by the Crown. Our review of the document provided by the Department in support of this statement indicated that the landlord did not make such a stipulation.

Total Costs for Leases

Place de Ville Tower C - Office Space Portion

	First 5 years		Second 5 years		Total
	Rate	Total $ Million	Rate	Total $ Million	$ Million
Original rates	$ 172/m²	$ 46.5	$ 240/m²	$ 64.8	$ 111.3
Revised rates	$ 255/m²	$ 68.9	$ 315/m²	$ 85.1	$ 154.0
Increase		$ 22.4		$ 20.3	$ 42.7

Centennial Towers

	1981 Value per Treasury Board Submission		$ 46.5
Original Offer per Treasury Board submission 11 December 1981	Lease-purchase (on a net lease basis)	Present Value	$ 61.5
Revised Offer per Treasury Board submission 22 June 1983	10-year Lease (converted to a net lease basis)	Present Value	$ 46.5
Difference			$ 15.0

13.35 **1133 Melville Street, Vancouver**. In April 1982, in response to requests from clients and after obtaining Treasury Board approval, the Department rented this building for a period of five years from 1 September 1982 for an annual rental rate of approximately $1.1 million.

Exhibit 13.5

EXISTING MAJOR LEASE-PURCHASE ARRANGEMENTS WITH CONTINUING PAYMENTS

Project	Term	Total Payments (Including Purchase Option) Estimated Total Payments Over Term (A)*	Option if Exercised at End of Term (B)	(A) + (B)	Present Value of (A) + (B) Assuming an Interest Rate of 14%	Estimated Capital Cost for Site Acquisition etc. as Shown in Estimates	Estimated Capital Cost on a Present Value Basis	Estimated Balance of Payments (Including Purchase Options) Outstanding 1 April 1984
				(Dollars in Millions)				
Place du Centre Hull, Que.	30 years	$ 90.2	$ 6.0	$ 96.2	$ 21.2	$ -	$ 21.2	$ 71.1
L'Esplanade Laurier Ottawa, Ont. (Note 1)	35 years	204.7	18.0	222.7	41.5	-	41.5	153.5
C.D. Howe Building Ottawa, Ont.	35 years	213.5	-	213.5	43.1	34.1	77.2	181.5
Les Terrasses de la Chaudiere Hull, Que. (Note 2)	35 years	510.2	54.0	564.2	103.6	14.8	118.4	426.4
Complexe Guy Favreau Montreal, Que.	35 years	449.2	30.0	479.2	91.0	96.8	187.8	445.0
Daniel J. MacDonald Building Charlottetown, PEI	35 years	89.6	-	89.6	18.0	8.7	26.7	89.6
Cornwall GOCB Cornwall, Ont.	35 years	48.2	-	48.2	9.4	-	9.4	48.2
Scarborough GOCB Scarborough, Ont.	35 years	196.0	10.0	206.0	38.4	6.8	45.2	206.0
Total		$1,801.6	$118.0	$1,919.6	$366.2	$161.2	$527.4	$1,621.3

Note 1: Building on developer-owned site.
Note 2: Building on site 21% owned by Crown and 79% owned by developer.

* Under most lease-purchase arrangements, rates fluctuate according to developer/lessor's refinancing rates. Amounts based on approved Treasury Board submissions or based on signed agreements.

13.36 In June 1982, one of the proposed tenants reported a change in requirements resulting from a decision to establish a new computer installation in Vancouver.

13.37 In December 1982 the Department requested additional funding from Treasury Board to fit up the premises for the revised requirements, and the request was approved by Treasury Board in February 1983.

13.38 Although the building was substantially completed and rental payments began in November 1982, it was not fully occupied until M[illegible]83 because of the length of time needed for approvals and subsequent fit-up work. [illegible] estimated unproductive rental payments from November 1982 to May 1983 amounted to approximately $529,000.

13.39 **Nugatory and other compensation payments**. Between 1975 and 1981, the Department negotiated new leases in three buildings in Ottawa to replace unexpired long-term leases. Departmental records indicate that this was in keeping with a general government program at that time aimed at alleviating the financial hardship being suffered by some landlords as a result of spiralling operating costs. The premise of the hardship negotiations was to make all leases equal and in accordance with DPW standards. The new leases were to offer fair market rents and appropriate escalation clauses. In exchange, the landlords had to agree to refit the buildings to meet departmental standards.

13.40 However, the Department did not ensure that the proposals it received were in a format that committed the landlords to the desired refit standards. In one case, even though Treasury Board approval deemed that the new rental rate would begin only after the upgrading had been completed, the signed leases did not include this clause. As a result, misunderstandings about the level of upgrading arose in each case, and the Department had to make substantial payments to the landlords.

13.41 We conclude that approximately $10 million of these payments are either nugatory (in that no value or service has been received by the Crown, but liability for them is recognized by the Crown), in the nature of a compensation for delays in occupancy, or for extra costs incurred by the lessor for which the Crown has received no additional or apparent benefit. In addition, because these payments were not identified or recorded as nugatory or unproductive, they were not disclosed in the Public Accounts of Canada.

Lease-purchase Arrangements

13.42 Since our 1979 comprehensive audit, the Department has reduced the number of buildings it is acquiring through Crown construction. It has instead acquired buildings by entering into a number of major lease-purchase arrangements (see Exhibit 13.5).

13.43 The Department, in a course for its officers, has described lease-purchase as "...a way of acquiring property over time and ... the equivalent of purchasing a building and financing it by a mortgage as all major developers and most of us do when we acquire, say, a residence."

13.44 These transactions are usually structured in the following manner:

- The site is normally Crown-owned. Pursuant to section 39 of the Public Works Act, it is considered as not being required for a public purpose and leased for one dollar to a developer for a specific term (usually 35 years).
- The developer constructs or completes the building according to the Department's specifications and his own or the Department's plans.
- The construction by the developer is periodically inspected by a project team consisting of DPW employees.
- After completion, subject to normal warranties, the building is operated, maintained and repaired by the Department, and the developer has few further expenses in connection with it. That is, the arrangement is fully net; all costs of maintaining, repairing and operating the building are borne by the Department.
- In effect, most of the risks and benefits of ownership are assumed by the Crown. For example, the arrangement for the Scarborough building states that destruction or damage of the building by fire or other peril will not terminate the arrangement. The Crown will have to repair, replace or reconstruct the premises to their original condition. However, these costs are covered by insurance, for which premiums are paid by the Crown, in addition to lease payments.
- Under the agreement, the Department makes monthly payments which are based not on fair market rentals but on amortization of the construction and financing costs quoted by the developer. The arrangement usually calls for options to purchase the building at various times during or on completion of the term, at a lump sum pre-determined amount or for the unpaid balance of the payments. The option price is such that there is little doubt that the Crown will eventually exercise its option and take over legal ownership of the building.

13.45 **Costs and disclosure**. The main reason given by the Department for choosing the lease-purchase option has been the conflict between increased demands for accommodation and the non-availability of funding for its capital program. Our examination revealed that the major differences between Crown-construct and lease-purchase are the source of financing and disclosure to Parliament.

- Because a private developer's borrowing power is less than the Crown's, the financing costs of lease-purchase acquisitions are considerably higher than those of other Crown-financed acquisitions. We noted that the interest rate developers are required to pay, which is used to determine the annual "rental" rate, is approximately 2 percentage points higher than what the Crown would pay if it had financed these acquisitions through the Minister of Finance. We estimate the excess financing cost to the Crown with respect to four recent lease-purchase arrangements over the 35-year term to be approximately $86 million, having a present value of $14.9 million (Exhibit 13.6). In the Department's opinion, some of the excess cost can be offset by the potential benefit in having the developer assume the risks during construction (i.e., delivery on time and within budget) as compared to Crown-construct projects.

- The total principal and interest payments required to finance the buildings acquired by lease-purchase amount to $1.9 billion, of which $1.6 billion was outstanding at 31 March 1984. This represents indirect borrowing through private developers which has not been disclosed to, and therefore not reviewed by, Parliament.

- Payments for acquiring space by lease-purchase are being shown as rental payments and charged to operating rather than capital expenditure. In our opinion, the true substance – acquisition of capital assets – and cost of these transactions have not been adequately disclosed to Parliament. This has led to a dilution of the parliamentary control and review normally exercised over the acquisition of such assets. At 31 March 1984, the difference between the costs shown in the Estimates and the actual costs of these capital acquisitions at present value amounted to approximately $366 million.

- The Department states that its current practices conform to prescribed government accounting practice, and future Main Estimates (Part III) will fully display all construction and financing costs associated with lease-purchase projects.

13.46 The Department of Public Works should disclose to Parliament the full cost and future funding requirements arising from acquisition of properties through lease-purchases.

13.47 **Authority.** The Department's practice of entering into long-term leases with developers at a nominal rental for the Crown-owned sites under section 39 of the Public Works Act implies that these sites are not required for public purposes.

13.48 Departmental documents and Treasury Board approvals clearly show that the lease-purchase arrangements are entered into for the sole purpose of constructing facilities to provide accommodation for the federal government. For example, in the case of the Scarborough building, one of the conditions under which the Ministers of the Treasury Board approved the Department's lease-purchase proposal was the verification of federal client space requirements.

13.49 In February 1982, the Minister of Public Works introduced Bill C-91, an Act to amend the Public Works and Public Lands Grants Acts to remove the condition, in

Exhibit 13.6

ANALYSIS OF FINANCING COSTS OF FOUR RECENT LEASE-PURCHASE ARRANGEMENTS: FINANCING THROUGH DEVELOPER VERSUS FINANCING BY CROWN

(dollars in millions)

Project	Developer's Project Cost	Government Long-term Borrowing Rate	Estimated Interest Rates to Amortize Project Cost Under Existing Arrangements		Estimated Principal and Interest Payments Over 35-Year term		Estimated Total Excess Interest Payment Over 35-Year term	Present Value of Estimated Total Excess Payment
			First 5 Years	Years 6 - 35	Under Existing Arrangements with Developers	If Financed by Crown		
	Note 1	Note 2	Note 3	Note 4		Note 5		Note 6
Scarborough GOCB	$ 38.9	13.56%	14.61%	15.56%	$204.0	$181.4	$22.6	$ 4.0
Daniel J. MacDonald Building	15.6	13.02%	14.71%	15.02%	79.4	69.9	9.5	2.0
Cornwall GOCB	9.6	14.22%	15.07%	16.22%	52.2	46.7	5.5	0.8
Complexe Guy Favreau	87.6	12.49%	13.00%	14.49%	427.3	379.1	48.2	8.1
Total	$151.7				$762.9	$677.1	$85.8	$14.9

Note 1 - Does not include cost of land or other costs borne by the Crown.
Note 2 - At completion of the building.
Note 3 - An interest factor ranging from 1.6% to 2.45% is added to the interest yield on cost of Canadian marketable bonds having a maturity of 5 to 10 years to calculate the annual payments for the first 5 years.
Note 4 - Based on the assumption that the developer's borrowing rate will be at least 2% higher than that of the Crown.
Note 5 - Using the Government long-term borrowing rate over 35 years.
Note 6 - Discounted at the Government long-term borrowing rate over 35 years.

connection with the sale or lease of a public work, that the public work not be required for public purposes. The Bill only received first reading.

13.50 In December 1983, the Deputy Attorney General of Canada stated that "...if it is accepted that property leased as part of a lease-purchase agreement is property required for public purposes, then sections 4 (Public Lands Grants Act) and 39 (Public Works Act) have no application". He further stated that the authority may be found in section 52 of the Financial Administration Act. However, he added that, "...the matter is not free from doubt and there are arguments which may be advanced in support of a different interpretation..." He recommended that "the government reintroduce legislation which will clearly authorize the Crown to enter into transactions relating to property required for public purposes, where such transactions will serve the public interest".

13.51 An independent legal opinion obtained by this Office for the Scarborough building states that "...the Crown was without authority under section 4 of the Public Lands Grants Act and section 39 of the Public Works Act to enter into the ground lease with the developer".

13.52 In addition to the problems concerning the leasing of Crown-owned sites, there were conflicting legal opinions given to the Department regarding the borrowing done to finance the transactions.

13.53 In March 1982, the Department obtained an independent legal opinion that the Charlottetown lease-purchase transaction did not constitute a borrowing by the Crown under section 36 of the Financial Administration Act. However, the Deputy Minister of Justice, on reviewing this opinion, suggested that the Department might wish to introduce legislation to deal with the policy issues arising from:

- the arrangement for payment for construction of a public work over a period of years after completion of the work; and
- granting what is, in effect, a mortgage of Crown property.

13.54 **The Department should seek clarification of its authority to enter into lease-purchase arrangements including, if appropriate, legislative amendments.**

Case Studies

13.55 **Government of Canada Building, Scarborough**. Our examination focused on the Department's definition of need for the building.

13.56 In July 1982, Treasury Board approved a departmental submission for the acquisition through lease-purchase of a 34,850 square metre building in Scarborough, Ontario. Total payments under this lease-purchase arrangement, including option to purchase, will amount to approximately $206.0 million ($38.4 million on a present value basis).

13.57 In granting approval, Treasury Board asked the Department to identify the prospective clients for the new building, their space authorities, volume of terminated leases, and the rate of return on the capital investment. In December 1982, Treasury Board once again asked the Department to verify client space requirements with off-setting lease data and to report to Treasury Board Secretariat the client space to be occupied.

13.58 At the end of our audit, the Department had still not complied with these requests. Our examination of the planning documents showed that the Department's own accommodation forecasts and plans do not support the acquisition of a building of this size in this location. The Metropolitan Toronto Accommodation Plan approved in December 1981 showed that the maximum demand for space in the Scarborough building would range between 17,500 to 25,800 square metres.

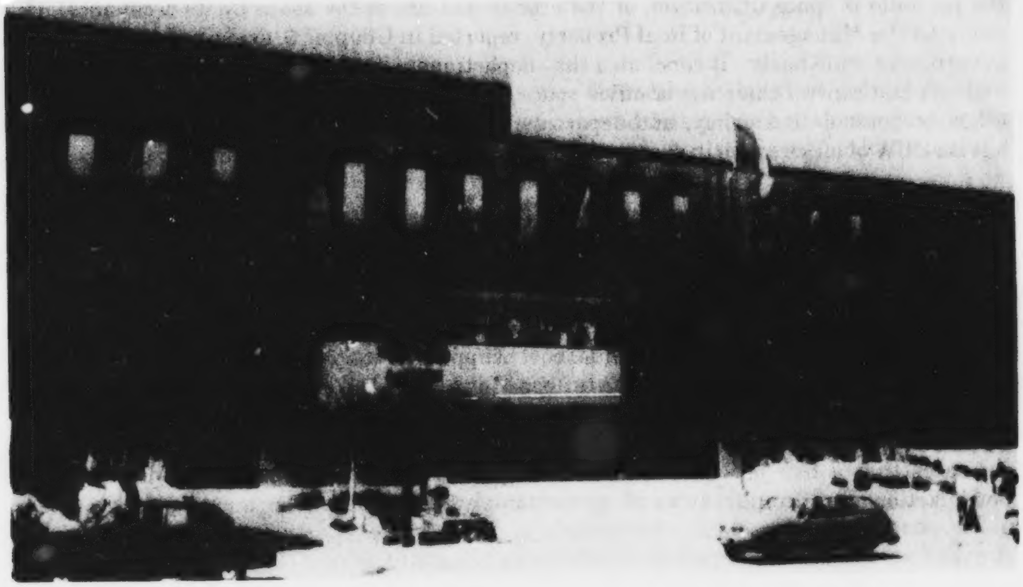
13.59 By April 1982, three months before obtaining approval of the space requirements from Treasury Board, the Department was aware that client requirements for general purpose office space in the greater Metropolitan Toronto area, with the possible exception of Mississauga, were expected to decrease substantially over the next several years. Clients had been identified for just over 50 per cent of the available space in the Scarborough building. In July 1983, a departmental study noted that client departments in Toronto had space in excess of Treasury Board standards ranging between 9,200 and 18,500 square metres at an approximate cost of $120 per square metre.

13.60 Our current government-wide study on Management of Real Property examined the space occupied by four departments in the Crown-owned Joseph Shepard Building in Toronto. We found that these departments are currently occupying 1,047 square metres in excess of Treasury Board standards, at a cost of $202,000 a year.

13.61 The Department advises us that the Scarborough building is now almost fully committed.

13.62 **Daniel J. MacDonald Building, Charlottetown**. Our examination focused on the acquisition and delivery of this project, which changed from a Crown construction to a lease-purchase arrangement.

13.63 The construction of the building was originally expected to be completed in 1981. Because of delays and changes in the site selection, caused by changes in government priorities, an electricians' strike, and deficiencies in the construction of the foundation and sub-structure, occupancy of the building was delayed until late March 1984.



Daniel J. MacDonald Building, Charlottetown, new headquarters for the Department of Veterans' Affairs

13.64 In January 1980, Treasury Board directed that a cost ceiling for the building be set at $16.5 million. To date, costs for the first phase of the project, primarily site acquisition and foundation construction, together with drawings and specifications for the building, have exceeded $9.0 million. In June 1983, Treasury Board noted a cost overrun in excess of $1 million in this phase. The present value of payments for the next 35 years, as calculated by the Department, is approximately $16.8 million. Thus the total project cost is approximately $25.8 million, or about $9 million more than the ceiling of $16.5 million set in 1980. In addition, the Department has had claims from two developers for $2.3 and $1.7 million arising from the changes in the site and deficiencies in the foundation and substructure. The first claim is under litigation. The Department has proposed a settlement of $790,000 for the second, but to date has made no attempt to recover this amount from the contractors concerned.

Management of Space

13.65 The Department's portfolio of over 8.5 million square metres of rentable space comprises both occupied space and, as of 1 April 1984, over 760,000 square metres of unoccupied space.

13.66 Our examination of the Department's efforts at managing their total space portfolio focused on the inventory of unoccupied space, the non-revenue producing component of the portfolio.

13.67 **Occupied space.** A major consideration with respect to the occupied space in the portfolio is space utilization, or the economical use of the space by its occupants. Our study on the Management of Real Property, reported in Chapter 6, examined this issue on a government-wide basis. It concluded that departments, including DPW, do not adequately manage and control their use of office space. Further, there is a general disregard for the office accommodation policy, and departments do not obtain Treasury Board approval or advise DPW of office space in excess of amounts prescribed in the guidelines.

13.68 For the accommodation included in our review, excess office space without Treasury Board approval amounted to 56,000 square metres, with a rental value of $9 million a year. A recent DPW study estimated that departments are currently occupying an amount of space in excess of Treasury Board standards which could range between 152,000 and 305,000 square metres, at an annual cost of approximately $120 per square metre.

13.69 In addition, the Department's latest IMPAC/revenue dependency plan indicates that a five per cent reduction in gross rents can be achieved through space optimization at an annual saving of approximately $35 million.

13.70 These problems raise serious concerns about what appears to be a general lack of management of space by all departments, including DPW.

13.71 **Unoccupied space.** At present, the portfolio mix and the environment in which DPW exercises its common service responsibilities for providing accommodation to federal departments and agencies is so different from that in which other public or private sector property owners operate that comparisons of DPW's management of unoccupied space with theirs would be misleading. For example, private sector clients would have cost avoidance incentives for returning excess or unoccupied space to the property managers, enabling the latter to maintain accurate vacancy rate calculations. DPW's clients do not have the same incentives, with the result that vacancy rates calculated by DPW are based on unreliable data. Further, the profit orientation of private sector realtors would mitigate against retaining unprofitable, unmarketable space. The combined effects of the absence of the profit motive, DPW's primary role as an agent of Treasury Board, and the Federal Land Management principle, which gives DPW the central responsibility for all surplus federal properties, results in an unoccupied space portfolio for DPW that cannot be compared to a private sector portfolio.

13.72 The Department's unoccupied space can be considered as being either space that has been declared surplus by client departments and transferred to DPW for development or disposal, or space that is immediately marketable or marketable with renovations.

13.73 The Department classifies unoccupied space in 11 categories that relate to the degree to which the space is committed to a planned use – for example, marketable to a federal client; designated to a non-federal client; being fitted up for a federal client; under study; or disposal approved.

13.74 Our examination revealed that the Department sees its primary role as providing accommodation to client departments and has placed a lower priority on managing its inventory of unoccupied space. We believe that the low priority accorded to managing unoccupied space is a cause for concern.

13.75 At least three essential elements are needed to enable DPW to manage its portfolio of space efficiently and effectively. First, the Department needs an accurate and reliable reporting system to identify the total unoccupied space. Next, it requires a system that captures the costs associated with this space, to prompt managerial action where warranted. Finally, responsibility and accountability relationships for managing unoccupied space must be clearly articulated to provide a focal point for action.

13.76 **Unoccupied space not being managed.** In early 1982, the Department assigned responsibility for the management of unoccupied space to a unit in Headquarters. We found that until March 1984, this unit had not begun to exercise its mandate. There are currently no incentives or penalties to encourage the Department or central agencies to minimize the inventory of unoccupied space.

13.77 The Department has advised us that it has now taken steps to rectify the situation by issuing policies and developing results indicators which will be used to set targets and monitor actual achievements in this area.

13.78 In response to our enquiries, DPW Management Audit in April 1982 conducted an analysis of the various categories of the vacant space inventory. This was the first such analysis conducted by the Department; the Department's managers had not perceived a need for such an analysis in the fulfillment of their managerial responsibilities.

13.79 **Unreliable system for reporting unoccupied space.** Regional managers did not have confidence in the Department's main report for identifying vacant space - the Detailed Vacancy Analysis Report. There were numerous inaccuracies in its data base, and the information it reported was unreliable and outdated. For example, a building acquired in 1976 in Ottawa for a client department has never been occupied but has never been shown as vacant space in the system. Instead, it had been classified as "designated" space for the past eight years.

13.80 During our physical inspection of the property at 1 Front Street, Toronto, the vacant space could not be reconciled with departmental records. Some of the space we saw had been vacant for six years but was classified as occupied. After our audit, the Department updated the information, changing the classification for about 50 per cent of the building's 31,064 square metres.

13.81 In view of the many inaccuracies we identified, and those recently reported by Management Audit, we believe that the Detailed Vacancy Analysis Report cannot be relied on in its present form as the basis for managing unoccupied space. The Department does not know with a reasonable degree of accuracy how much unoccupied space there is and therefore cannot make a consistent effort to put it to efficient use or seek other solutions.

13.82 The Department recently has made efforts to improve the Report by introducing a new Facilities Inventory System. In our opinion, the situation will only improve if the Department, in addition to updating the system, significantly upgrades the supporting data base and institutes control measures to ensure the integrity of the data.

13.83 **Cost of maintaining unoccupied space.** While we acknowledge that there should be a way of identifying space which is to be fitted up in preparation for occupancy by a specific client, the existing departmental practice of withdrawing such space from the market by designating it to the prospective client can lead, and has led, to the property remaining unoccupied for several years while at the same time being unavailable for alternative short or long-term uses. Examples of this unproductive use of space include the Bank of Canada Building in Ottawa and Place du Portage IV in Hull.

13.84 We found that Parliament and the central agencies have not been well informed about the real cost of unoccupied space. The Department does not separately identify the total operating and maintenance cost of its unoccupied space inventory. As a result, we have been unable to examine and report on the magnitude and validity of this cost. Our audit of a sample of 326,270 square metres of the Department's reported unoccupied space (47 per cent of the total) identified a cost to Canadian taxpayers of over $22.6 million for operating and maintenance costs and grants in lieu of taxes. This does not include imputed interest charges, capital costs or estimates of foregone revenues. It does, however, include the total time over which each parcel of space we examined remained unoccupied.

13.85 Not included in the above is the cost of the 87,600 square metres of space currently unoccupied at Goose Bay, Labrador. This situation is mainly a result of a 1976 government policy decision to scale down federal government involvement in Goose Bay, leaving the Department with a unique socio-economic problem.

13.86 Because the total space inventory is a blend of office accommodation, housing, commercial space, storage and other categories of space, it is not possible to extrapolate the cost of our sample to the entire space population. However, our review of the Department's own figures for vacant space and foregone revenues related to unoccupied space (excluding space approved for disposal) for the past five years has revealed the following:

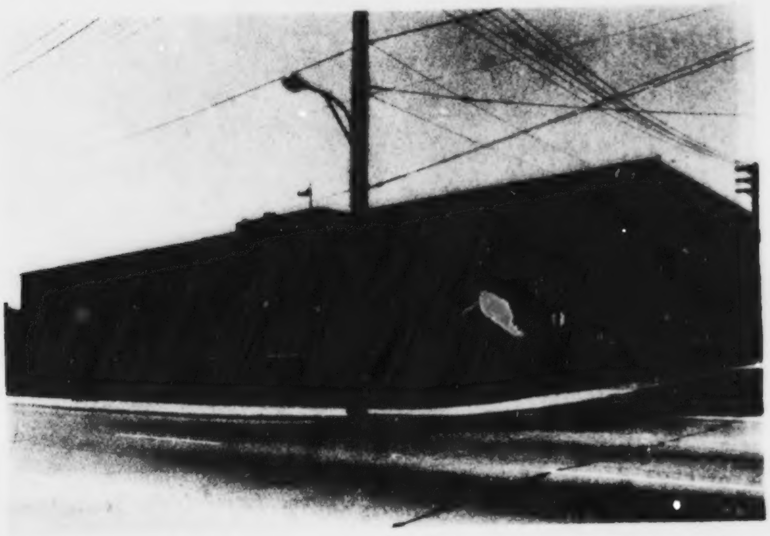
	1980	1981	1982*	1983*	1984*
Vacant Space (m² thousands)(1)	736	655	687	682	714
Foregone Revenue ($ thousands)(1)	$25,024	27,107	32,413	26,728	23,990

(1) From DPW's records (operating and maintenance figures not available).

* Canada Post Corporation space separated and excluded.

13.87 The Department has advised us that it currently has no mechanism for routinely tracking and highlighting the actual costs attributable to vacant space, but that this will be possible with the Financial Management System under development. This system will not be operational until 1986 at the earliest.

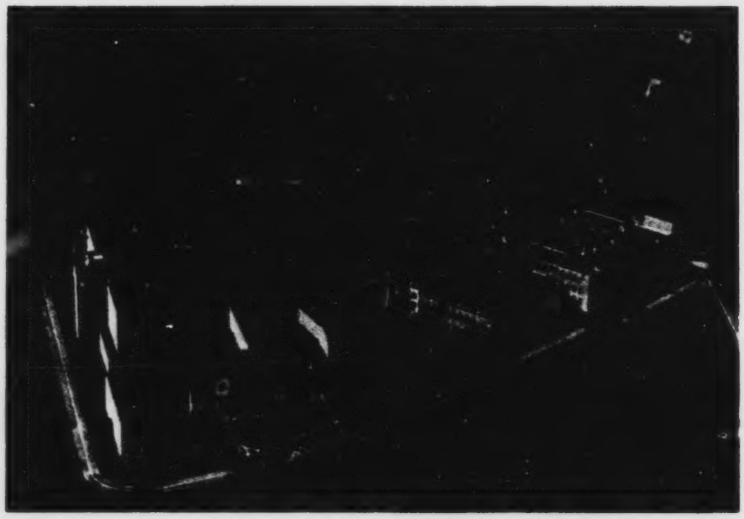
13.88 **Contributory causes of unoccupied space.** The unreliability of the reporting system was such that the extent of unoccupied space could not be determined, and thus no overall opinion could be formulated on the quantities, definitions, categories or causes. For the space that we reviewed, the main causes were poor planning by both DPW and client departments and the transfer of surplus properties to DPW. Another significant cause was that the funds required to make space marketable were sacrificed to higher priorities for other government policies and programs.



Bank of Canada building, Ottawa, unoccupied since its acquisition in December 1981.

13.89 The Department's decision to renew two leases in the Commercial Building, Moncton, was made without having first identified potential clients for the space. The result has been 4,892 square metres of vacant space maintained at a total operating cost to 31 March 1984 of approximately $857,000. The Ottawa Teachers' College, which has been declared a heritage property, has remained vacant for four and a half years while the City of Ottawa has conducted studies and proposed a long-term lease. The result has been 4,404 square metres of rentable vacant space maintained at a total operating cost including grants in lieu of taxes of $1,063,077. The Mulligan and Bank of Canada buildings in Ottawa were acquired several years ago for clients who later changed their requirements, and the buildings have never been occupied. The result has been 20,351 square metres of vacant space maintained at a total operating cost to 31 March 1984 of $837,720. Centennial Towers in Ottawa was leased by DPW with rental payments beginning December 1983. Full occupancy is not expected until sometime after November 1984; the Department estimated total unproductive rental payments of $4.4 million for this building.

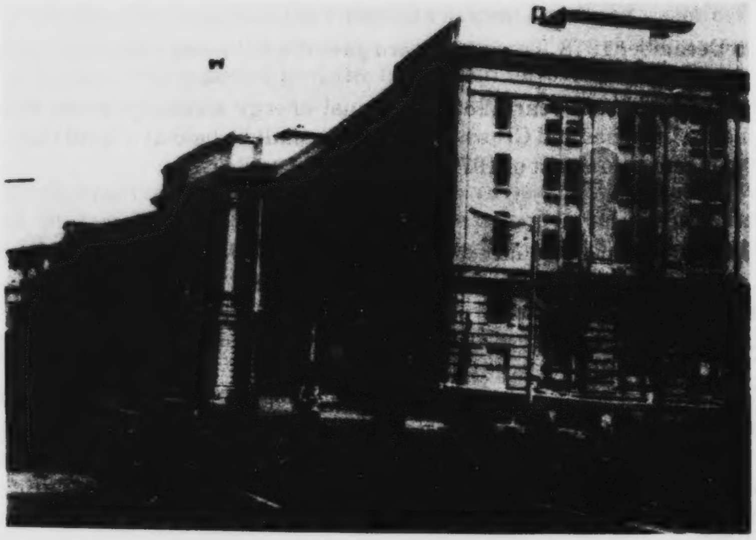
13.90 The Government's decentralization policy led to the Department's quick decision to acquire the Scolasticat Ecole Normale Saint-Viateur in Rigaud, Quebec as a training institution for Revenue Canada. The institution's 24,700 square metres of space stood completely vacant from December 1977 to April 1980, and remains approximately half vacant at present, at a total operating and maintenance cost including grants in lieu of taxes to 31 March 1984 of $1,766,881.



The Customs and Excise College, Rigaud, Quebec, formerly the Scolasticat Ecole Normale Saint-Viateur.

13.91 The Government's policy to distribute public service employment throughout the National Capital Region led to the construction of the Place du Portage complex in Hull. Total vacant office space in Portage IV is now approximately 17,100 square metres, of which nearly 3,000 square metres have never been occupied. The total cost to 31 March 1984 to maintain this vacant space has been $3,909,551.

13.92 DPW studies and requests for project approval began in late 1976 for a proposed $41.5 million renovation project in the Dominion Public Building, 1 Front Street, Toronto to convert approximately 9,300 square metres of vacant space to marketable office accommodation. Completion of the project would remove the need for $7.5 million in annual lease payments in Toronto's downtown core. The Department's accommodation planning has been rendered ineffective by the delays in the project, while costly short-term leases have been entered into until the long-term accommodation plan of consolidation in the Dominion Public Building can be realized. Effective project approval was not received from Treasury Board until May 1984, following a delay of nearly eight years.



Dominion Public Building, 1 Front Street, Toronto. Renovation proposals made since 1978 were approved in May 1984.

13.93 The Daly Building in Ottawa has been vacant since February 1980, and its 13,316 square metres of space cost a total of $775,967 to 31 March 1984 to maintain. Approval for demolishing of the building was given by Treasury Board in March 1982 but was later withdrawn at the urging of heritage groups in favour of possible redevelopment options. A formal offer to acquire the property was received in November 1983 and is currently being considered by DPW.

13.94 To ensure that the Department's new Facilities Inventory System supports management decisions on unoccupied space, the system should contain appropriate control measures to ensure the integrity of the data base that supports it.

13.95 The Department should institute a system for capturing actual costs of unoccupied space to assist its managers in arriving at accommodation decisions involving a selection among alternatives, and also to disclose to central agencies the cost of unoccupied space resulting directly from implementing government policy decisions.

13.96 Management of unoccupied space should be given a high priority and visibility within the Department. This should include regular reviews of the national inventory of unoccupied space and related costs, so that appropriate action can be taken by management to find uses for the space.

Energy Conservation

13.97 In December 1978, Treasury Board gave the following direction:

> Until the end of fiscal year 1985-86, annual energy consumption by federal departments, agencies and Crown corporations shall be held at a level that is at least 10 per cent below that of 1975-76.

13.98 Treasury Board also directed that, within each department and agency, there should be an organization to monitor all direct and indirect consumption of energy and to develop and see to the implementation of measures to conserve energy and the involvement of all employees in the program.

13.99 Audits by our Office and the departmental Management Audit group in 1981 found that many plans had been implemented by the Department. Energy conservation measures were generally considered to be effective, although some deficiencies in implementation still existed.

13.100 Our current examination revealed that although some potential for additional savings still exists, the Department has made considerable efforts to achieve the target set by Treasury Board and has indeed reduced the annual level of energy consumed in government facilities.

13.101 Except for buildings acquired through lease-purchase, the Department has generally complied with Treasury Board directives for Crown-owned properties it administers. Although plans had been developed for reducing energy consumption levels in some leased properties, they had not been implemented at the time of our audit. The

Department stated that it did not have the regulatory powers necessary to impose energy conservation requirements on private sector landlords.

13.102 The Department has the mandate to implement projects to encourage the use of solar energy. Some progress has been made, notably implementation of the Program of Assistance to Solar Equipment Manufacturers and the Low Energy Building Design Awards to promote good solar design practices. The Purchase and Use of Solar Heating program was also launched by making government buildings the first market for solar energy installations. While the Department of Energy, Mines and Resources is accountable for these programs, DPW was given responsibility for managing them. These programs were not intended to be economically viable but were designed to encourage and support industrial development in these areas. Department records indicate that approximately $40 million was spent nationally under the solar heat program up to 1983, when the Government decided to phase it out and replace it by a program of subsidies to the private sector.

The Budgetary Process

13.103 In 1979, we examined the budgetary system and found major deficiencies, such as the absence of a cost accounting system, standards and norms and an overall planning and control system. We reported that the foundation for sound operational planning and control was missing.

13.104 Our current examination involved a review of the present structure and procedures that make up the budgetary process and a follow-up of our previous recommendations. We concentrated on the budgetary system for funding and operating one of DPW's major mandates, Crown properties. This planning element anticipates expenditures of $169 million in 1984-85, of which $96 million is for operating and maintenance costs and $28 million is for cyclical repairs.

13.105 Although the Department has made some improvements in the structure of its budgetary system, the foundation for sound operational planning and control is still incomplete.

13.106 The operational planning manual and the Property Administration's Works Management System have improved the planning exercise by providing a common set of procedures and imposing a planning discipline. The Operational Planning Framework introduced in 1983 is used to rationalize and justify the relationship of results to objectives and of results to resources to be consumed. The full benefits of this will not be realized until 1985-86, when the new Financial Management System will be implemented. It will then be possible to compare actual with planned results.

13.107 Of the $214.9 million requested by DPW in 1983-84 for operations and maintenance and cyclical repairs for Crown properties, $113.7 million is not verifiable because documentation linking regional submissions with the global averages used in the consolidated corporate submission is missing. Also, we found that budgetary procedures are not uniformly followed in the regions. In the Ontario and National Capital regions, project work plans were well prepared and adequately supported by analyses of needs. In the Manitoba district office, however, operating work plans were not prepared in the autumn for the 1984-85 fiscal year as required by the Department's property administration manual. In the Edmonton regional office, work plans for operating and maintenance costs were based on historical costs plus incremental or inflationary adjustments. Project work plans were based on dollar value "guesstimates" and general provisions for broad based activities and contingencies. As a result, a large portion of the $13 million requested in 1983-84 by the Western region could not be verified by a review of detailed work plans. Also, property managers did not plan and budget for orderly maintenance of buildings.

13.108 In a recent departmental study, three-quarters of the 39 buildings examined were identified as needing catch-up maintenance. In spite of this recognized need, however, funding has been reported as being only sufficient to cover emergency breakdown repairs.

13.109 Financial officers were not involved in analysis, challenge or approval of regional operating plans. At Headquarters as well, Finance's role was limited to making arrangements after key decisions had been made. This meant that costing inputs and assumptions and historical data were not formally reviewed and challenged.

13.110 Headquarters Property Administration did not contribute to the long-term implications of resource requests in the 1983-84 and 1984-85 regional work plans. However, for the 1985-86 operational plan, we noted there was increased involvement.

13.111 **Life-cycle maintenance plans.** The Department does not have formal, costed life-cycle maintenance plans based on periodic structural inspections. We did not find plans, covering both mechanical systems and structural elements, for any of the four buildings we examined. Although the buildings audited in the National Capital and Ontario regions were inspected for mechanical, electrical and operational maintenance requirements, we saw limited evidence that any roofing, architectural or structural inspections were being carried out as part of a formal life-cycle maintenance plan.

13.112 We concluded that a longer term planning horizon, as evidenced by a costed out complete life-cycle maintenance plan, would provide the best basis for budgeting for Crown-owned properties. In our opinion, the absence of such plans indicated that even though property managers were preparing budgets, they were often not planning.

13.113 The Department's basic system to achieve a predetermined level or quality of maintenance is the Facilities Inspection program, which has, for the most part, been in place since 1977. The current status of implementation of the program is approximately 50 per cent in the National Capital and Quebec regions and 10 per cent in other regions. Our examination revealed that because of delays in implementation, this system is not effective in ensuring that work plans include all the workloads necessary to achieve a predetermined level or quality of maintenance. This leads to inconsistencies in the quality of accommodation provided to clients.

13.114 **Prior recommendations.** Although some initiatives are currently under way, none of the Office's 1979 recommendations designed to remedy serious deficiencies and provide property managers with necessary tools has been completely implemented.

13.115 **Cost accounting system.** In 1979 we recommended that DPW should develop and implement an improved accounting system, including cost accounting, to produce a data base of relevant, reliable and timely information for input into every management information system in the Department. The Department agreed, and recognized that cost accounting was a priority item.

13.116 During our current examination, we noted that DPW property managers still did not have the use of an acceptable cost accounting system. As before, reports were aimed at exercising control over cash, not comparing actual costs to budgets, with explanations related to performance.

13.117 Property managers found the existing quarterly building report of limited use because it comes out three months late, is on a cash basis, does not include all relevant costs, and does not facilitate variance reporting.

13.118 The Department advised us that the new Financial Management System, which will be implemented 1 April 1986, will include a cost accounting module.

13.119 **Unit costs.** In 1979 we recommended that DPW develop unit costs for each building, to form the basis for resource requirement planning for the operation and maintenance of buildings. We also recommended that the Department implement a performance evaluation system based on unit costs as soon as possible and use it to control operating and maintenance costs.

13.120 The Department agreed and stated that a unit cost study begun in 1978 had been extended and expanded and the results obtained were considered to be of sufficiently acceptable quality to support valid analysis. DPW also agreed that a performance evaluation system was an essential link in comparing planned and actual results.

13.121 During our current examination, we noted that the unit cost system, which is designed to produce standard costs and identify inefficient operations, is not used by regional officers to monitor and control major buildings. DPW reports that unit costs are used at the Headquarters level of portfolio management to budget for resource requirements and assess regional performance against unit cost targets. However, in our opinion, this potentially useful tool has not been fully used, and the validity of its data base has not yet been fully tested.

13.122 We found limited evidence that the Department had established building-specific performance standards, or norms, to assist in forecasting, evaluating current performance against these standards, and analysing trends. The unit cost system does not include other important elements of building performance such as potential revenues and building condition.

13.123 As a result, DPW property managers still lack the necessary tools to forecast resource requirements, evaluate performance, challenge resource requests, analyse investment alternatives and control the operations and maintenance costs of individual Crown-owned properties. There have been few new solutions to old problems.

13.124 The Department should ensure that the budgetary procedures are uniformly followed in all regions.

13.125 Finance and Property Administration Branches should be involved in challenging and reviewing of the norms used to cost inputs, key financial assumptions and historical data used in preparing annual plans.

13.126 The Department should develop and implement standards for the level of maintenance as quickly as possible and have fully costed life-cycle maintenance plans for its Crown-owned properties.

IMPAC/Revenue Dependency

13.127 In August 1980, DPW responded to our recommendations and those of the Standing Senate Committee on National Finance and the Lambert Royal Commission on Financial Management and Accountability by preparing a discussion paper recommending revenue dependency to Cabinet. This paper proposed to improve the utilization of accommodation and professional services by charging departments market rates for those services, and to improve the management of the accommodation and other professional and technical services provided by the Department by placing these activities on a revenue dependent basis.

13.128 The overall objectives for the revenue dependency system were to improve the effectiveness and efficiency of DPW, improve parliamentary control over accommodation costs, and minimize the costs of accommodation. The proposal was formally approved by Cabinet in January 1981, and later a decision was made by the Department to combine implementation with Improvement in Management Practices and Controls (IMPAC) activities, as recommended by the Office of the Comptroller General, many of which were considered to be prerequisites.

13.129 Cabinet directed the Department to conduct an evaluation (or simulation) project before charging client departments for accommodation and realty services, and provided a short statement of seven factors that were to form the basis for evaluating the project. Simulation was one of the principal terms of reference designed to evaluate the adequacy of the the proposed revenue dependency system. The focus of the simulation exercise began in the Atlantic region on 1 October 1982. The target implementation date for revenue dependency was set for 1 April 1984, and a separate Branch was established within the Department under an Assistant Deputy Minister.

13.130 By the spring of 1983, due to the failure of a recently acquired software package, client concerns and other related factors, the Department realized that it was not possible to have a fully operational revenue dependency system by April 1984. In July 1983, Treasury Board considered and approved deferral of the implementation date. DPW has now adopted a gradual or "incremental" approach to implementation, with an earliest possible full start-up date of 1 April 1986.

13.131 We reviewed the IMPAC/Revenue Dependency Project from the time of Cabinet approval in principle in January 1981 to July 1983, when the decision was made to defer the proposed implementation date of April 1984.

13.132 We examined the project planning and costs, and reviewed the Management Audit group's work and departmental responses on the limited implementation of the project and related activities.

13.133 **Nature of the task.** For DPW, the project was a complex, unique and ambitious undertaking. It was made up of 4,000 activities spread over three years. Revenue dependency was a highly visible issue which would have a major impact on the way in which both the Department and its clients were to plan, manage, finance and report on accommodation resources.

13.134 We believe that successful implementation of the project would have required exposure of key DPW employees to revenue dependency concepts and familiarity with matching market-based rents against the costs of operation. This requirement, coupled with the absence of an in-house infrastructure for planning and developing the required large, complex multi-disciplinary EDP systems, provided an additional challenge to successful project management.

13.135 **Planning.** The Department's Project Delivery System and Treasury Board's EDP guidelines provide a good framework for the overall planning and implementation phases of large projects. While the Department intended to follow these procedures for the project, we noted that in practice, often because of time constraints, the guidelines were not fully implemented.

13.136 The Department's Master Plan for Implementation provided a starting point to define the issues and activities in very general terms. However, an initial consideration of workload implications and overall project feasibility was not formally updated following Cabinet approval of the project and DPW's decision to expand its scope. A feasibility study focusing on the costs and benefits of EDP system implementation alternatives was not prepared. As a result, DPW did not adequately provide for the risks involved, the complexity of the project, the costs and the time required to complete it.

13.137 The Department did not identify the essential user requirements at an early enough stage, when the implications of critical scope decisions could be determined and negotiated before costly commitment of resources. Considerable work has to be done in systems development to complete the present Incremental Plan.

13.138 **Costs.** The Department embarked upon the IMPAC/Revenue Dependency Project without a proper analysis or estimate of the magnitude of the costs involved. The initial estimate of the cost given to Treasury Board in 1980 was $3.7 million subject to modifications as a result of system diagnostic work. The Department states that this estimate related only to certain IMPAC projects and costs to implement charging but excluded systems development costs.

13.139 The full costs of the project were not estimated until three years after the project had started and are now stated to be $45.8 million (Table 1). The Department advised us that of this amount, approximately $5 million relates to revenue dependency and the balance of approximately $40.8 million is being spent on improving the various management systems, under IMPAC initiatives.

13.140 In our opinion, given that the Department has been fully aware of the need to improve its systems for many years, the total costs of the project should have been estimated and disclosed to Treasury Board at the outset.

13.141 We noted that there was no ongoing project accounting to record and monitor the full costs of the project. There was no initial total project budget that could be linked to specific outputs, or a fixed ceiling or benchmark that could be used to control costs. DPW states that it estimated manpower requirements on an annual basis; however, we noted that there was no system in place to compare the estimates against the actual utilization. The costs shown in Table 1 are based on approved Treasury Board submissions and a DPW cost study initiated at the request of Treasury Board in June 1983. They are only estimates and exclude costs borne by clients and central agencies.

Table 1
IMPAC/Revenue Dependency Costs
Estimated Costs to Complete

(dollars in millions)

	Original July 1981 (1)	System Replacement August 1982	Latest Revised November 1983 (2)	Estimated Outlays to March 1983
Person-years	38	*	747	258
$ Value of person-years (3)	$ 1.3	*	$ 22.4	$ 8.0
Contract	$ 2.4	$ 12 - $ 13	$ 23.4	$ 9.0
Total $	$ 3.7	*	$ 45.8	$ 17.0

(1) Estimate subject to modification as a result of system diagnostic work.
(2) Project completion in 1986-87, includes system replacement.
(3) 1 person-year = $30,000.
* There was no indication of person-years needed to complete the projects.

13.142 Our analysis showed that there was no clear, visible link between planned results and original budgets and final deliverables and costs. The major tangible outputs of the $5.2 million spent on systems development, as estimated by DPW in their one-time cost study, were functional specifications for four major EDP systems, which were originally estimated to cost $883,000, and a pilot project for another system. Because of the large amounts spent for infrastructure, project management and simulation, which resulted in interim or intangible outputs such as "lessons learned", we concluded that it was very difficult for DPW to compare costs with tangible planned results on a project-by-project basis.

13.143 **Results.** We could not evaluate the contribution of results to July 1983 because none of the major project segments was complete, tested and ready for use. DPW believes that the simulation was a valuable learning experience for the Department and its clients. However, the Department did not test several essential features of revenue dependency, such as the operation of revolving funds, the use of internal agreements, the ability to support the reduction of DPW appropriations and the increase of other departmental appropriations. Critical areas that were tested, such as rental rates and fee structures, indicated a significant need for improvement. To date, there is no overall conclusion about the adequacy of the revenue dependency system or the viability of the concept.

13.144 DPW is projecting a total investment of $45.8 million for improving administrative processes and systems. At 31 March 1983, $17 million had been spent, but an acceptable cost accounting system had still not been implemented as recommended as early as 1962 by the Glassco Commission. The financial management system developed in 1975 included several modules designed for charging clients. It was deemed inadequate by the Department in 1981. The solution to a deficiency first reported over 20 years ago will not be fully operational until April 1986 at the earliest.

13.145 Because so many of the individual pieces of IMPAC/revenue dependency are inter-related, it is difficult to judge their value in isolation. To achieve full benefit, they must all be in place. For example, the full impact of the planning framework will not be felt until the accounting system allows the comparison of actual with planned results. In short, trying to make qualitative assessments now is like looking at individual bricks rather than the whole building.

13.146 We will examine the implementation of IMPAC/revenue dependency in our follow-up work in subsequent years.

Marine Program

13.147 The Department's operations under the Marine Program are divided into two broad areas – Industry Support activities, including construction, improvement, maintenance and operation of dry dock facilities, dredges and support facilities and vessels; and Water Level Control, including maintenance and operation of various locks and dams across the country and special studies to develop engineering criteria in the field of water level control.

13.148 We examined Industry Support, the Department's principal area of activity under the Marine Program. We reviewed dry dock operations, in particular the efforts of the Department to recover the cost of these operations. Our examination of the Department's dredging operations was designed to follow up on the activities covered in our 1980 government-wide study on Materiel Management.

Dry Dock Operations

13.149 Under the Public Works Act, the Minister is responsible for maintenance and operation of the Crown-owned dry docks at Lauzon, Quebec; Selkirk, Manitoba; and Esquimalt, British Columbia. The Department acts as the owner/operator of the facilities and rents them along with associated services to ship repair contractors. The use of the facilities is subject to a tariff of charges authorized by Order in Council. There is only one principal user for each of the facilities at Lauzon and Esquimalt.

13.150 The tariffs for user fees for the Esquimalt and Lauzon docks are specified in schedules to the general regulations that apply to the docks. The last fee revision for the Esquimalt dock was in September 1971, and for the Lauzon dock in September 1965. The need to revise these rates was reported by the Management Audit group in 1974 and again in 1976.

Esquimalt Graving Dock, operated by DPW since 1925: one of the three federally funded drydocks on the west coast.

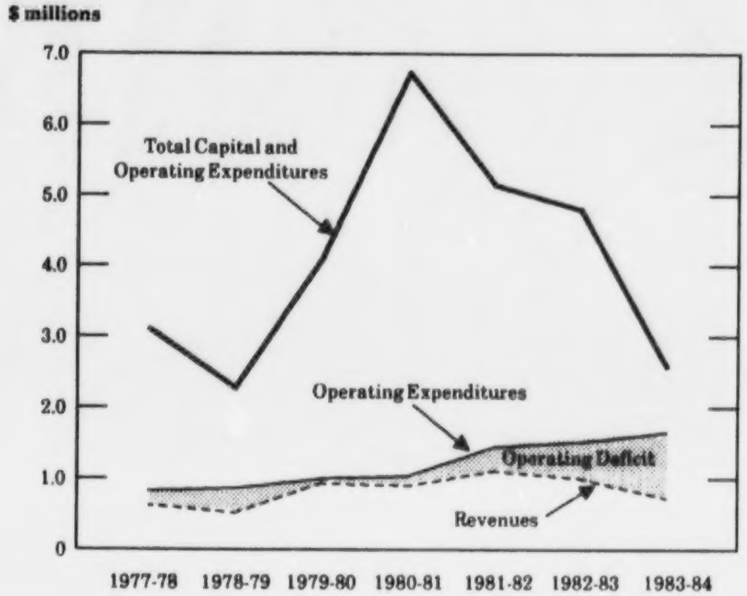
13.151 In 1971, when the existing charge-out rates of $10 and $12 an hour were set for cranes in the Esquimalt dock, the average wage of crane operators was $4.53 an hour. Currently, crane operators' average wages are $14.81 an hour, some 20 per cent more than the charge-out rates, without even considering costs for electricity, repairs and capital.

13.152 The operations of the Esquimalt Graving Dock and the Lauzon Dry Docks have resulted in total operating losses of approximately $8.6 million since 1977 (Exhibit 13.7). The Department states that these losses are a component of its "Support to Industry" mandate. However, based on our review of the original Cabinet decision of 1975 and subsequent Treasury Board pricing policy relating to charges for services to the public, we believe these losses constitute an unauthorized and undisclosed indirect subsidy to a single principal user at each dry dock.

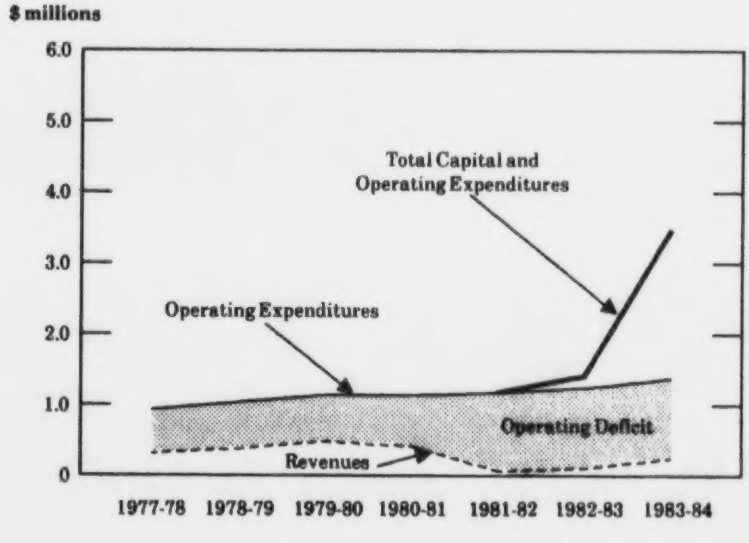
13.153 In October 1981, DPW asked the Department of Justice to review the Department's new rate proposal. When the Government announced its 6-and-5 program in the summer of 1982, the Department proposed to Treasury Board a revised rate structure with tariff increases of up to 250 per cent. Treasury Board rejected the proposal, noting that the Department had not seen any need to adjust these tariffs since 1965 in one case and 1971 in the other, and was only proposing to do so when the Government's inflation restraint program was such a high priority. The Department has advised us that Part III of the Estimates will fully disclose the above costs in future.

Exhibit 13.7

TOTAL EXPENDITURES (CAPITAL AND OPERATING) AND REVENUES - ESQUIMALT GRAVING DOCK 1977-78 TO 1983-84



TOTAL EXPENDITURES (CAPITAL AND OPERATING) AND REVENUES - LAUZON DRY DOCKS 1977-78 TO 1983-84



Cranes operating at the Esquimalt Graving Dock. Charge-out rates do not cover operating expenses.

13.154 **Esquimalt Graving Dock.** The Department has taken the view that its role here is custodial in nature, with the responsibility for both marketing and booking the dock traditionally being assumed by the contracting user. A recent DPW study reports that the principal user markets the facility as though it runs the dock; the Department appears to have little control over either the rates charged by the contractor or the actual use of the facility.

13.155 There appears to be little co-ordination in the marketing and operations of the three federally-funded dry docks located on the west coast. DPW is committed to Esquimalt, the facility it has owned and operated since 1925, and for which it is spending $30 million in modernization projects. The Department of Regional Industrial Expansion has a vested interest in ensuring the success of a floating dock in nearby Vancouver, a facility for which the Department of Industry, Trade and Commerce provided contributions of over $40 million in 1978. The Department of National Defence, which has its own dry dock next to DPW's in Esquimalt, views DPW's dock as an excellent facility for work on DND ships. The work is done using private sector repair companies.

13.156 **The Department should clarify its mandate for providing financial support to the ship repair/ship building industry through absorbing the annual**

operating losses for the Esquimalt Graving Dock and the Lauzon Dry Docks and should disclose to Parliament the extent of these subsidies.

13.157 The Department should obtain Treasury Board guidance on its role in a co-ordinated federal policy on the marketing and operation of the three federally funded west coast dry docks - Esquimalt Graving Dock, Esquimalt (DND) dry dock, and the Department of Regional Industrial Expansion's floating dock in Vancouver.

Dredging Operations

13.158 The objective of DPW's Dredging and Fleet Services activities is to provide federal departments and agencies with marine dredging service of accepted standards, norms and levels of service.

13.159 Annual dredging volume by DPW is approximately 70 per cent of the estimated total average annual Canadian dredging volume. The work is divided between private contractors and DPW's own fleet of 23 dredging vessels and 80 support craft. This fleet has a 1982 replacement cost of about $107.6 million.

13.160 In 1980, we examined the Department's dredging operations and made a number of recommendations which were accepted and later incorporated in a broader DPW study. Our current examination revealed that only limited progress had been achieved by the Department in implementing the recommendations. Of particular concern is the fact that the key policy recommendations, which established the overall frame of reference, have not been implemented. These address the criteria for the use of the DPW in-house dredging fleet, the development of a common cost accounting system for all DPW regions, and cost sharing for dredging services.

13.161 The serious implications resulting from the Department's failure to implement the key policy recommendations are that the efficiency and effectiveness of the fleet and individual dredges cannot be evaluated and cannot be compared with operations in the private sector. The need for such an evaluation has been rendered even more critical by the government's recent announcement that preference is to be given to private sector contracting for federal government dredging work, while recognizing that the government may be required to maintain some in-house dredging capacity.

Professional and Technical Services Program

Architectural and Engineering Services

13.162 The Architectural and Engineering Services (A&ES) provided by the Department involved 1,612 person-years and approximately $120 million in expenditures in 1983-84 These professional and technical services were provided to client departments and agencies, as well as other DPW programs, with advisory services in design, construction and project management of buildings and marine and transportation facilities. The organization consisted of approximately 240 person-years in Headquarters, providing project assistance and support, and another 1,372 person-years in the six DPW regions.

13.163 We looked at the organization and management of Architectural and Engineering Services activities; our review did not extend to the quality of the output or services provided by this group. As a result of our findings, we have significant concerns about the planning and control of A&ES resources and the role of its technology organization.

13.164 **Planning.** In the private sector, in operations like A&ES, resourcing norms or standards have been developed and are being used to plan the level and type of resources allocated to projects.

13.165 The Department undertook two separate studies, one in 1977 and one in 1983, to identify and define norms for resourcing A&ES projects. However, in reviewing the project files, we found no evidence that these resourcing norms had been used in the projects currently under way. The Department indicated that some norms are used at the level of overall resourcing of the function. However, we could find no evidence that these norms had been used to help in determining the level or type of future workload.

13.166 Our concern is further increased by the following evidence. The Department has just completed an "A-base review" of the National Capital Regional Architectural and Engineering Services in which it compared the A&ES resources with overall capital expenditures. We have used the same assumptions to compare A&ES resources across all regions with construction resources. These are shown in the following table.

Table 2
Capital and Architectural and Engineering Services Expenditures
(Department and Consultants)
(dollars in thousands)

Year	1978-79	1979-80	1980-81	1981-82	1982-83
A&ES Expenditures	$ 80,648	65,504	62,941	74,971	83,892
Capital Expenditures	$ 481,221	293,304	279,209	382,143	395,471
A&ES as a Percentage of Capital Expenditures	16.76%	22.33%	22.54%	19.62%	21.21%

13.167 A&ES expenditures (including consultants) as a percentage of capital expenditures have increased from 17 per cent in 1978-79 to over 21 per cent in 1982-83. Without the application of resourcing norms at a project level, it is impossible to determine the precise cause of these fluctuations. Had the Department maintained the 1978-79 level of resourcing in proportion to capital expenditures, the difference in cost would have amounted to $61 million.

13.168 Under revenue dependency the services of the A&ES unit will be fully costed, and clients will be charged service fees at market rates.

13.169 The Department has prepared pro forma income statements which show that if the current activities of the A&ES unit were carried out on a fully-costed basis, the costs associated with these activities would exceed revenues by approximately $30 million a year.

13.170 One of the objectives of revenue dependency is to bring these costs into balance with service fee revenues. The Department estimates that this can be achieved over the next five years.

13.171 **Control of operations.** The Department's main tool for monitoring its operations is its Time Reporting/Project Monitoring System. All current projects are required to be recorded in this system.

13.172 Our review of the status of current projects recorded in the system revealed that 49 per cent of them had not been formally approved, using the system definitions, and the Department had not budgeted or allocated any resources for them. This varied considerably across the regions with one region having less than 25 per cent of its projects approved. The lack of formal approval or allocation of funds for approximately 50 per cent of the total workload raises serious questions about the control and use of A&ES resources.

13.173 The information used for managing projects is contained in the Time Reporting/Project Monitoring System and in project files maintained by the regional offices.

13.174 In response to our enquiries, the Department could not produce certain essential information on the projects. In all regions, in the majority of projects reviewed, information was not readily available on either the time of A&ES personnel allocated to the project or the reasons for using consultants. As well, information was frequently missing on reasons for changes in costs, whether construction actually resulted from the project, evidence of the control of the project, and the date the project was requested and by whom. In one region, 15 of the 60 project files were not available. Without such information it would be difficult to manage projects in an efficient and effective manner.

13.175 We also compared the information contained in the system with the information we obtained directly from the project files. In all of the projects, some of the key information in the system was not consistent with that kept in regional files. To the extent that the information in the system is not accurate and up to date, it would be difficult to use it either as an information source or as a base for exerting functional control and guidance over projects.

13.176 The responsibility for ensuring quality control on construction projects has been assigned to the A&ES unit by the Department. We reviewed the project files to determine the extent to which Headquarters and regional A&ES personnel exerted quality control on the projects. We would have expected to find minutes of meetings with consultants, sign-offs on drawings and plans, and other indications of monitoring the quality of projects. In the majority of cases (52 per cent) we could find no evidence of any form of quality control or monitoring by A&ES staff. Without evidence of such work, the Department cannot determine whether the A&ES unit is fulfilling its mandate and achieving its objectives.

13.177 Headquarters A&ES staff stated that its quality control could not easily be seen from evidence in a file and might, for example, be exercised through meetings with committees of the various disciplines. However, in our opinion, given that the Department provides resources to the Architectural and Engineering Services amounting to approximately $120 million annually, it is imperative that it keep track of the use of these services on projects, at least for control and performance appraisal of groups and individuals.

13.178 The Department advised us that it has now issued a comprehensive directive on quality control and believes that the implementation of this, along with more extensive records, will help rectify the situation.

13.179 **Role of Technology Branch.** Currently, within Headquarters, the Technology Branch uses 150 person-years and has $7.6 million of expenditures other than salaries. In our review of 184 projects, we noted only 11 in which there was any documentary evidence of Headquarters Technology activities.

13.180 We were informed by regional DPW personnel that they did not use Headquarters Technology to any great extent and were unsure of its activities and role. However, Headquarters staff indicated that they had reviewed a number of projects done by the regions.

13.181 In our opinion, this lack of clarity of role and relationships inhibits the effective use of the services provided by the Technology Branch.

13.182 **The Department should develop and use norms for planning the allocation of resources to projects.**

13.183 The Department should review and validate key information contained in the Time Reporting/Project Management System and project files so that projects can be managed in an efficient and effective manner.

13.184 The Department should ensure that the activities essential for Architectural and Engineering Services staff to carry out quality control on construction projects are clearly defined and properly recorded.

13.185 The Department should review and clarify the role and mandate of the Headquarters Technology Branch with the regions.

Audit and Evaluation

Management Audit

13.186 Our examination of the Management Audit group of the Department focused on the following areas: organization and mandate; planning; coverage; identification and reporting of issues; and implementation of change.

13.187 Our review indicated that Management Audit operates effectively as an integral part of the management control process in the Department. We found that Management Audit has reacted well to the priorities of senior management in planning the use of audit resources. Observations raised are well substantiated and, equally important, are reported on a timely basis for the consideration of management. In addition, there is clear evidence that Management Audit has been an important participant in effecting positive change within the Department.

13.188 A significant factor in the effectiveness of the function may be the depth of knowledge and understanding of DPW as an audit entity acquired by the Management Audit staff over the seven years of its existence.

13.189 Management Audit has recently concentrated its audit efforts on the more significant issues in the Department, as shown by its work in such areas as revenue dependency. This has contributed to the value of its findings. This kind of emphasis on significant issues is consistent with current direction given to internal audit functions across government.

Program Evaluation

13.190 The corporate Program Evaluation unit at DPW was established in October 1982. Since then it has used approximately nine person-years and over $500,000. Our audit examined the infrastructure of the unit as well as the evaluation products completed at the time of our audit.

13.191 We found the program evaluation infrastructure to be consistent with our criteria for the establishment and operation of a program evaluation function. The deputy head has approved an evaluation policy, a long-term program evaluation plan and program component profiles. We found these generally met our audit criteria. The budgetary and person-year allocations were consistent with planned activity.

13.192 At the time of our audit, the unit had completed five evaluation products, one of which was a special study. Although the products did not fully meet our audit criteria, we found the quality of these products to be consistent with expectations for a recently established program evaluation unit.

> Department's response: *The Department advises us that it agrees with our recommendations and is taking steps to implement them. A senior manager has been assigned to ensure prompt implementation.*

SECRETARY OF STATE

SECRETARY OF STATE

Table of Contents

	Paragraph	Page
Audit Scope	14.1	14–1
Observations and Recommendations		
Management of Translation Services	14.7	14–1
Education Support Program	14.38	14–7
Canada Student Loans Program	14.49	14–8
Exhibit		
14.1 Organization Chart		14–2

14

SECRETARY OF STATE

Audit Scope

14.1 Our audit of the Secretary of State dealt with the significant operational elements of the Department – education support, translation, and citizenship registration – because of the size of the personnel or financial resources devoted to them as well as because of their effects on other departments and on Canadian society in general.

14.2 We assessed existing systems by means of sampling, analysis and interviews with employees at all levels, with the objective of determining whether the Secretary of State takes economy and efficiency into account in managing its programs.

14.3 We audited the internal audit function and used some results of work by the Internal Audit Directorate in our review.

14.4 We did not audit the activities of the Program Evaluation Directorate, because this was the subject of one of our government-wide studies in 1983.

14.5 We did not review the information to Parliament in Part III of the Estimates, because it had not been published at the time of our examination.

14.6 Nor did we examine the Translation Bureau's process for awarding linguistic services contracts, because indepth studies on this subject are currently under way.

Observations and Recommendations

Management of Translation Services

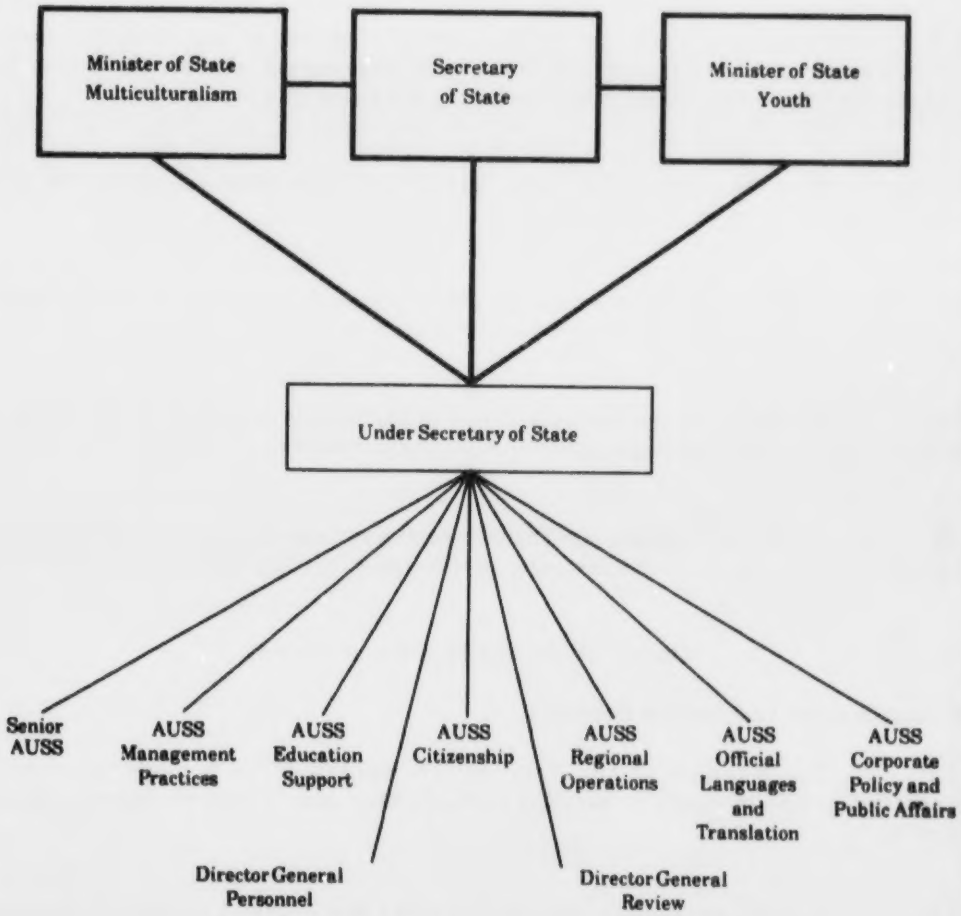
14.7 The mandate of the Translation Bureau is to provide translation, interpretation and terminology services to Parliament and to federal departments and agencies.

14.8 To fulfil its mandate, the Bureau had 1,800 employees, 1,200 of whom were translators, and a budget of $82 million in 1983-84.

14.9 Our review covered the Bureau's major function – providing translation services. We examined whether the Bureau had measures in place to organize, monitor and evaluate its translation activities. We found that, in general, managers were not giving

Exhibit 14.1

DEPARTMENT OF THE SECRETARY OF STATE
SUMMARY ORGANIZATION CHART
1 OCTOBER 1984


Minister of State Multiculturalism
Secretary of State
Minister of State Youth
Under Secretary of State
Senior AUSS
AUSS Management Practices
AUSS Education Support
AUSS Citizenship
AUSS Regional Operations
AUSS Official Languages and Translation
AUSS Corporate Policy and Public Affairs
Director General Personnel
Director General Review

adequate attention to managing operations and that the control of translation activities was insufficient.

14.10 **Strategy for deploying resources.** Each year, the Translation Bureau responds to requests from 150 clients for translations totalling 300 million words. This is the equivalent of almost 1,000 Auditor General's Reports. In the past few years, roughly 25 per cent of this work has been contracted to outside translation firms and freelancers. In 1983-84, the value of these contracts was $8 million.

14.11 To make informed choices about distributing work among its own translators, outside firms and freelancers, and to develop a long-term strategy for deploying its resources, the Bureau should be aware of the effects of the factors that have an impact on translation.

14.12 We observed that the Bureau has begun to establish a system for costing translation done in-house and that done by outside contractors and has made a study of the freelance market. Such a system is essential for capturing the data on which to base strategic choices; however, the Bureau has not yet analysed the relative costs and benefits of using internal resources and private firms and freelancers. As a result, the Bureau does not know whether it is fulfilling its mandate in the most economical way.

14.13 **The Translation Bureau should analyse the relative costs and benefits of using internal resources and of using private translation firms and freelancers and should develop a strategy for achieving its objectives in the most economical way.**

> Department's response: *The Bureau agrees with this recommendation. It started to develop a new operational information system in 1983-84 so as to better analyse and compare the costs of internal and external translation. The system should be operational in 1986-87, at which point it will be possible to make the necessary comparisons and to develop a strategy.*

14.14 **Monitoring productivity.** We checked whether the Bureau had set realistic production standards and whether it had a system to monitor the efficiency of its translators.

14.15 In 1979, the Bureau abandoned the standards it was using at the time of our 1978 audit in favour of a management approach based on individual objectives. Management nevertheless defined production capabilities to serve as benchmarks between the various levels of translators for purposes of planning and for promoting employees. We were unable to discover what data had been used to establish these production benchmarks.

14.16 We observed that the production capabilities are perceived and used in diverse ways within the Bureau: some see them as minimum standards; others see them as long-term objectives; and still others disregard them entirely. The result is confusion about how to use them and a lack of uniformity between sections in setting work goals for translators at the same level.

14.17 We conducted productivity surveys using as a standard the production capability benchmark established by the Bureau for professional translators at the TR-2 level.

14.18 We sampled the productivity of 39 per cent, or 280, of the translators at that level. The results showed that, for 1982-83, 67 per cent of the translators sampled were performing below the production capability established for their level. The Bureau would have been able to translate approximately 20 million additional words had all TR-2s met the production capabilities set out for them.

14.19 **The Translation Bureau should establish production standards and ensure that they are used.**

> *Department's response: Parallel with the comprehensive audit, the Bureau was developing a study on productivity management. A pilot project will be carried out to determine production standards for various sectors of translation operations. Once realistic standards have been established, they will be applied throughout the Bureau. Standards will be enforced beginning 1985-86.*

14.20 **Control of workload.** About 90 translation sections and sub-sections of the Bureau are located in departments to respond better to their needs. Some sections may be overloaded at times because of heavy volume or tight deadlines, while others are underutilized.

14.21 We observed that the senior management of the Bureau does not have the information necessary to monitor and distribute the workload among sections. Managing overloads and shortfalls is left to the discretion of section heads, and there is no central control to ensure the optimal division of the workload among sections and between internal and freelance resources. There is therefore a risk that some sections are under-utilized at the same time as overloaded sections are sending work out to freelancers.

14.22 In July 1984, the Bureau started to establish a production control unit to correct this deficiency.

14.23 **The Translation Bureau should ensure that its managers use the information provided to them by the production control unit in order to distribute workload in a satisfactory way.**

> *Department's response: The Bureau agrees with this recommendation.*

14.24 **Service to clients. The quality of the service the Bureau provides to clients is governed by the quality of its translations and by the extent to which it meets deadlines.**

14.25 We observed that in 1979, the Bureau had set a quality standard for itself. Since then, there has been no improvement in quality, and the proportion of translated texts which do not meet a given standard has remained at 62 per cent of all texts delivered to clients. The Bureau has neither revised its 1979 standard nor set out a detailed plan for achieving the standard within a reasonable time.

14.26 Of all texts handled in 1982-83, the Bureau did not meet the deadlines negotiated with clients in 26 per cent of cases. This amounts to 41,000 texts. There is no control system to monitor work in progress to ensure that deadlines are met. Nor does the Bureau follow up on the reasons for missed deadlines.

14.27 **The Translation Bureau should:**

- **review the relevance of its translation quality standard, establish a plan for achieving the standard, and set deadlines for implementing the plan; and**
- **exercise systematic control over work in progress to ensure that translation deadlines are met, follow up to discover the reasons for missed deadlines, and try to eliminate them.**

Department's response: In co-operation with its clients, the Bureau will review the appropriateness of its quality standards for translation and will develop an implementation plan for the beginning of 1985-86.

When it starts using the operational information system in 1986-87, the Bureau will be able systematically to follow up on delays and to keep track of the many changes to completion dates (requested by clients) in order to respond to changes in priorities.

14.28 **Human resource management. Our audit revealed several shortcomings in this area, particularly regarding human resource planning, clear definitions of roles and responsibilities, and fairness in promotions.**

14.29 With respect to human resource planning, information systems do not provide all the necessary data on the characteristics of the Bureau's personnel complement. For example, there was no information on translators' previous working experience that would be useful in meeting the needs of various current clients, nor was there information on the number of specialist translators or autonomous translators. No plan exists that takes account of the effects on human resources of operating objectives such as automation, productivity improvement, greater autonomy for translators, and so on, all of which affect recruitment and the deployment and training of personnel.

14.30 The Translation Bureau should:

- **identify the basic information requirements for human resource planning; and**
- **establish human resource action plans to take account of the Bureau's operating objectives.**

> Department's response: *The Secretary of State agrees with these recommendations. Before 1985-86, the Translation Bureau and the Personnel Branch will define the information needs and set up a system to provide the data necessary for effective management of human resources. They will analyse the effects of the operational objectives on human resources and ensure that they are reflected in the human resource plan for 1985-86.*

14.31 With respect to managing translation services, responsibility for supervising, distributing work assignments, conducting evaluations, and maintaining liaison with clients is not clearly assigned to revisers, section heads or directors.

14.32 The Translation Bureau should clarify the management roles and responsibilities of employees at each level in the organization.

> Department's response: *The Translation Bureau agrees with this recommendation. It will have up-dated management roles and responsibilities for the various organizational levels by the beginning of 1985-86.*

14.33 In promoting TR-1s to TR-2s, the criteria used are not applied uniformly. For example, our examination of the promotion files for 1983 showed that the required production capacity varied considerably from one individual to another.

14.34 The Translation Bureau should ensure that promotion criteria are applied uniformly.

> Department's response: *The Secretary of State has set up a committee of Bureau managers and Personnel Branch specialists whose terms of reference are to develop a policy regarding the promotion of TR-1s. A report on this matter is expected by the end of fall 1984, and the ensuing policy should be approved and implemented by the beginning of 1985-86.*

14.35 **Process for awarding contracts.** During 1983-84, allegations of certain conflict-of-interest situations regarding linguistic service contracts and involving Translation Bureau employees led to establishing an administrative review conducted by a group from outside the Secretary of State reporting direct to the Under-Secretary.

14.36 The administrative review group has already submitted several reports. The group recommended steps to improve control over the process for awarding contracts to freelancers, and the Secretary of State has begun to act on those recommendations.

14.37 At the time of our audit, it was too soon to tell to what extent the problems had been solved.

Education Support Program

14.38 In 1966, the Secretary of State was assigned a mandate to act as the central agency for co-ordinating the development, implementation and review of federal programs relating to education. The Department also speaks for the federal government in federal-provincial relations in the field of education. This mandate was reinforced by a 1973 Cabinet directive.

14.39 Support to education provided by the Secretary of State takes three principal forms. Payments to the provinces and territories under the Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977, as amended in 1982, and aid to students under the Canada Student Loans Program, are made by the Education Support Program. Payments to the provinces under the Official Languages in Education Program are made by the Official Languages Program.

14.40 Payments under these three support programs amounted to roughly $2 billion in 1982-83.

14.41 Our audit focused on whether these policies and programs were aimed at specific objectives; whether an effective mechanism existed to co-ordinate federal and federal-provincial activities; whether the Secretary of State had the means to evaluate the extent to which it was achieving program objectives; and, finally, whether moneys had been spent for the purposes for which they were voted.

14.42 The Secretary of State has established federal objectives in education, and its programs are aimed at achieving them. Achieving the objectives, however, requires the participation of other federal departments and, above all, the provinces, which have exclusive jurisdiction over education. Mechanisms and a strategy to ensure co-ordination among the interested parties are thus essential.

14.43 We discovered that, despite consultation between the Secretary of State and other federal agencies – for example, the Canada Employment and Immigration Commission, the Social Sciences and Humanities Research Council, the Department of National Defence and the Department of Indian Affairs and Northern Development – there is as yet no satisfactory mechanism for co-ordination at the federal level.

14.44 The Secretary of State should establish mechanisms to enhance co-ordination among all federal agencies for the purpose of achieving federal objectives in the field of education.

> Department's response: *The Secretary of State agrees it should enhance co-ordination among all federal agencies. In this vein, it has recently established, with Statistics Canada, a new survey of federal activities related to education. As well, in accordance with recent legislative changes, the Secretary of State must now report annually to Parliament on these activities. This year, the Department will also explore other means to enhance co-ordination at the federal level, beyond collaboration with other federal departments and agencies on specific issues.*

14.45 As regards co-ordination with the provinces, contacts between the Secretary of State and the provinces tend to centre on specific educational issues or more general financial questions. They do not deal with programs or fundamental problems in the field of education, such as priorities, mobility, equality of access and quality of education. It must be recognized that the Secretary of State would have difficulty setting up co-ordination mechanisms or procedures in a field where it does not have principal responsibility.

14.46 The Secretary of State should consult with the provincial governments on the ways to achieve federal objectives in post-secondary education.

> Department's response: *The Secretary of State intends to renew consultations with the provinces relating to the definition of national purposes to be served by post-secondary education and the means by which the Government of Canada and the provinces will achieve these purposes.*

14.47 The Secretary of State has no means in place to assess the extent to which program objectives are being achieved. Efforts are under way to establish a bank of data on students, programs, educational institutions, and courses of study. This information is essential to the development and evaluation of policies and programs.

14.48 Despite the size of the annual payments made by the Secretary of State to provinces under the Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, there is at present no requirement for provinces to account for their use of these funds. Consequently, the Department does not know whether the funds are actually being used for the purposes for which they were approved. The Department is now considering the possibility of an agreement with the provinces on a system of accountability for their use of these funds.

Canada Student Loans Program

14.49 The Canada Student Loans Program administers the Canada Student Loans Act. The purpose of the Act is to make financial help available to students in need, to handicapped students, to the unemployed and to former borrowers who require assistance to carry on studies at the post-secondary level.

14.50 Under the Program, the federal government guarantees loans made to students by chartered banks and other designated lenders on the basis of Certificates of Eligibility issued by provinces participating in the Program. The government pays the interest on these loans while the students continue studies and for six months afterward.

14.51 The Department allocated $185 million for the Program in 1983-84 for interest, for claims and for an alternative payment to the province of Quebec, which administers its own program. Approximately 230,000 students benefited from the Program in that period.

14.52 We reviewed the steps the Department has taken to follow up on recommendations we made in 1977, 1979 and, particularly, 1981 concerning internal control weaknesses in the student loans electronic data processing (EDP) system; in the design of the EDP system; and in the management of the project for developing a new EDP system.

14.53 **Present system.** Counting on the fact that a new system would be in place by April 1983, the Secretary of State did little to modify its existing system. Consequently, internal control of the student loans system is weak.

14.54 In anticipation of the introduction of the new system, the Secretary of State began to correct all the data recorded in the existing computer data base in the autumn of 1983. Despite these efforts, incorrect data remain in the system, with the result that significant errors or irregularities could occur and remain undetected for a long time.

14.55 Moreover, the new system may produce information of poor quality because the data base on the actual student population used for the new records will come from the old system.

14.56 The Secretary of State should correct the information in its present data base on the Canada Student Loans Program.

> Department's response: *The Secretary of State agrees. It has already initiated a quality review of the previous file purification work. File purification will again be pursued, as required, before the implementation of the new computer system.*

14.57 **System under development.** The general EDP design for the new system has taken into account our concerns about internal control. Progress on developing the system had not proceeded far enough for us to determine whether the system, once implemented, will contain the controls outlined in the general design. However, the Secretary of State has set up mechanisms to control the quality of the developmental work being done and to ensure conformity with the general design.

14.58 **Project management.** Since the project began in 1980-81, there have been weaknesses in its operations and organization.

14.59 After seven years, the EDP system for controlling student loans is still not up and running:

> **December 1977:** The Computer Systems Directorate started, and then, because of lack of resources, abandoned overhauling the system.
>
> **In 1979:** The Management Services Bureau of the Department of Supply and Services recommended that a new system be designed, and a team was set up to develop the general design.
>
> **During 1981:** Because of the complexity of the program, a steering committee was established to consider the question.
>
> **November 1981:** The team's mandate was set out.
>
> **December 1981:** The planning was completed.
>
> **January 1982:** The detailed work began.
>
> **April 1982:** The team's mandate was enlarged to include grants as well as loans and to meet new needs arising as a result of potential changes in legislation.
>
> **July 1982:** The feasibility study was almost complete.
>
> **January 1983:** Following the decision to make no changes in legislation, the objectives of the task were revised back to approximately the 1981 objectives, and the general design phase began again.
>
> **April 1984:** The new general design was almost completed, at a cost of $2 million.
>
> **February 1985:** Testing and installation are planned for completion at this date.

14.60 Since 1977, the Auditor General has made a number of observations on financial control weaknesses in the system. Also since 1977, the Department has made changes and enhancements in the design of the control systems over data for program operation, but there have been no developments or enhancements in the design of financial control systems. Even though the basic objective of financial control has not changed, all the weaknesses identified since 1977 have still not been corrected.

14.61 With respect to administration, responsibilities of the project leaders were not clearly set out before the end of 1983. The detailed implementation plan, which should allow departmental managers to forecast delays and their effects on implementation and to take the necessary steps to minimize them before proceeding to the next stage, is not satisfactory.

14.62 **The Secretary of State should exercise strict and continuing control over progress on the project, and particularly over changes and target dates.**

> Department's response: *The Secretary of State is taking the necessary measures to ensure adequate project control. Responsibilities are clearly defined; the work plan and the updating procedures will be recast at an appropriate level of detail.*

ORGANIZATION AND PROGRAMS OF THE OFFICE OF THE AUDITOR GENERAL

ORGANIZATION AND PROGRAMS
OF THE OFFICE OF THE AUDITOR GENERAL

Table of Contents

	Paragraph	Page
Introduction	15.1	15–1
Organization of the Office	15.4	15–3
Audit Operations	15.7	15–5
Professional Services	15.24	15–8
Administrative Services	15.32	15–10
Program Evaluation and Internal Audit	15.38	15–10
Advisers to the Auditor General	15.41	15–11
Reporting Responsibilities	15.43	15–12
Public Accounts Committee	15.44	15–13
International Activities	15.46	15–13
The Canadian Comprehensive Auditing Foundation	15.54	15–15
Canadian Conference of Legislative Auditors	15.55	15–15
Human Resources	15.56	15–15
Women in the Office	15.59	15–16
Official Languages	15.61	15–16
Employment for the Handicapped	15.63	15–17
Deaths and Retirements	15.64	15–17
Technical Resources	15.66	15–19
Financial Resources	15.70	15–19

Exhibits

15.1 Abridged Organization Chart of the Government of Canada 15–2

15.2 Organization of the Office of the Auditor General 15–4

15.3 Appropriations and Expenditures 15–18

15.4 Value Audited Versus OAG Expenditures 15–20

15

ORGANIZATION AND PROGRAMS OF THE OFFICE OF THE AUDITOR GENERAL

Introduction

15.1 The Office of the Auditor General is part of the legislative branch of government. The Auditor General is an Officer of Parliament, reporting direct to the House of Commons. The Auditor General Act (reproduced as Appendix A to this Report) ensures that the Auditor General remains independent from the executive branch of Government and that he is answerable only to Parliament. Exhibit 15.1 shows the place of the Office of the Auditor General within the Government of Canada.

15.2 The Auditor General's mandate requires him to examine the Government's financial transactions, verify the information presented to him, and report his findings to the House of Commons. His mandate also requires him to provide assurance to Members of Parliament that public moneys have been economically and efficiently spent for the purposes intended, and that there are procedures in place to enable those who administer programs to measure the effectiveness of those programs.

15.3 In considering the scope of his mandate, the Auditor General has stated that his mission is:

- to make independent examinations of the accounts of federal departments and agencies and of other entities for which he is the appointed auditor, and to express his opinion on their integrity;

- to make such independent examinations and inquiries as he considers necessary and, based on them, to report on whether or not there were significant deficiencies in the management control systems and practices in the audited entity during the period under examination; thereby providing reasonable assurance, where possible, that:

    - public assets are safeguarded and controlled;

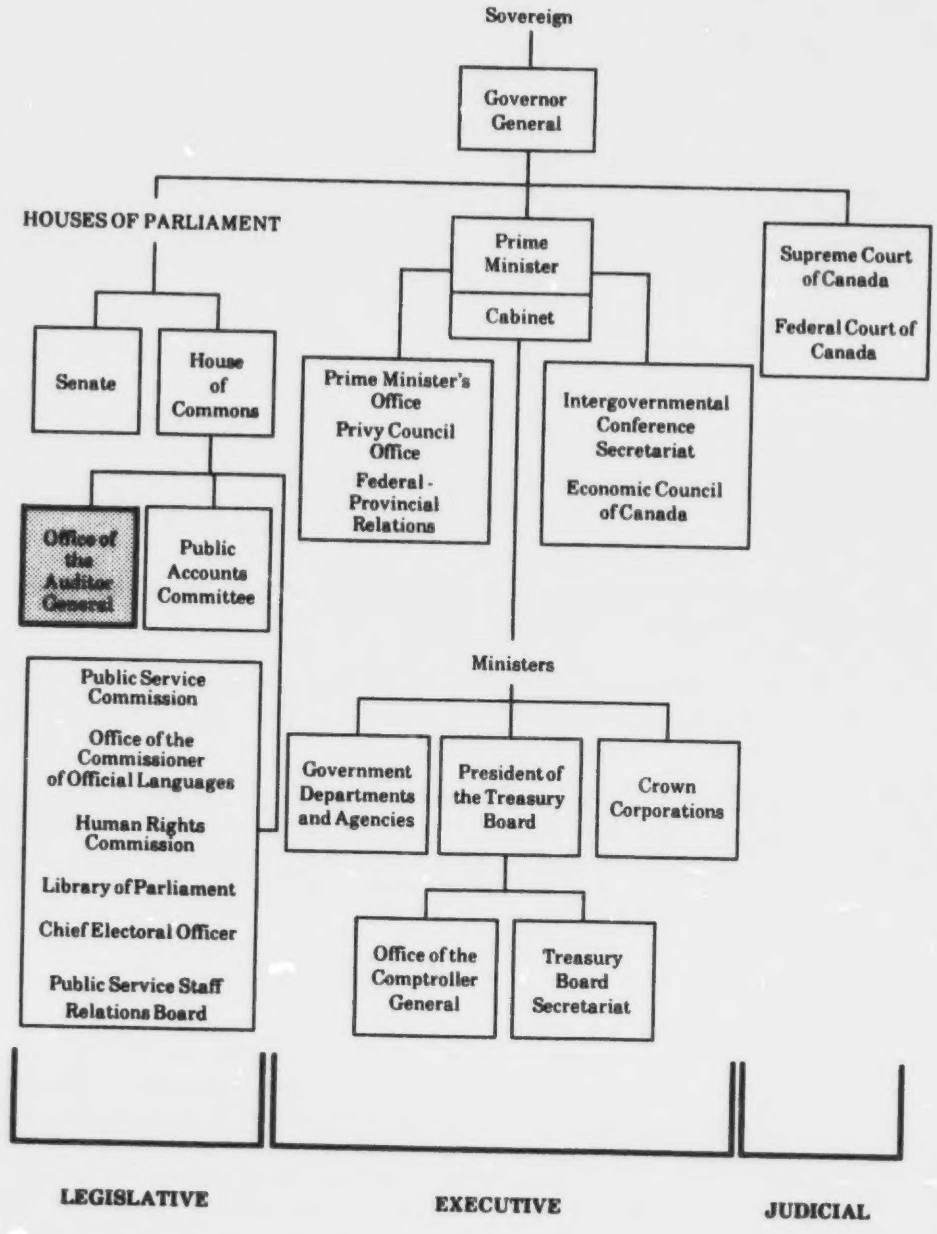
    - transactions are lawful and proper;

    - financial, human and physical resources are managed with due regard to economy and efficiency, and procedures are in place to measure and report the effectiveness of programs;

- to call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, to communicate his findings and observations to management of the audited entity and to make any constructive recommendations he may have;

Exhibit 15.1

ABRIDGED ORGANIZATION CHART OF THE GOVERNMENT OF CANADA


Sovereign
Governor General
HOUSES OF PARLIAMENT
Senate
House of Commons
Office of the Auditor General
Public Accounts Committee
Public Service Commission
Office of the Commissioner of Official Languages
Human Rights Commission
Library of Parliament
Chief Electoral Officer
Public Service Staff Relations Board
Prime Minister
Cabinet
Prime Minister's Office
Privy Council Office
Federal - Provincial Relations
Intergovernmental Conference Secretariat
Economic Council of Canada
Ministers
Government Departments and Agencies
President of the Treasury Board
Crown Corporations
Office of the Comptroller General
Treasury Board Secretariat
Supreme Court of Canada
Federal Court of Canada
LEGISLATIVE
EXECUTIVE
JUDICIAL

- to maintain the stature of his Office, share its expertise with Canadian and international colleagues, and contribute to the development of comprehensive audit methodology and practices; and

- to manage his Office with due regard for economy, efficiency and effectiveness, ensuring professional and administrative competence and adherence to applicable government policies.

Organization of the Office

15.4 In September 1984, the Office of the Auditor General underwent a major reorganization. The Auditor General articulated the reasons for the change, as follows:

- to consolidate all auditing functions within one branch in order to improve co-ordination and integration of audit work;

- to clarify and distinguish the functions of Deputy Auditors General (DAGs) and Assistant Auditors General (AAGs) by:

    - providing more responsibility for AAGs to manage Audit Groups; and,

    - enabling the DAGs of Audit Operations to play a more active role in assisting the Auditor General to review critical issues and to perform a general management function in directing overall planning, administration and resource allocation within Audit Operations;

- to reinforce the aim of the Office to develop strong core audit teams and groups that have considerable knowledge, on a continuing basis, of the departments and entities they audit and;

- to increase the productivity of audit work by enabling AAGs and Principals to plan and manage resources within their Audit Groups.

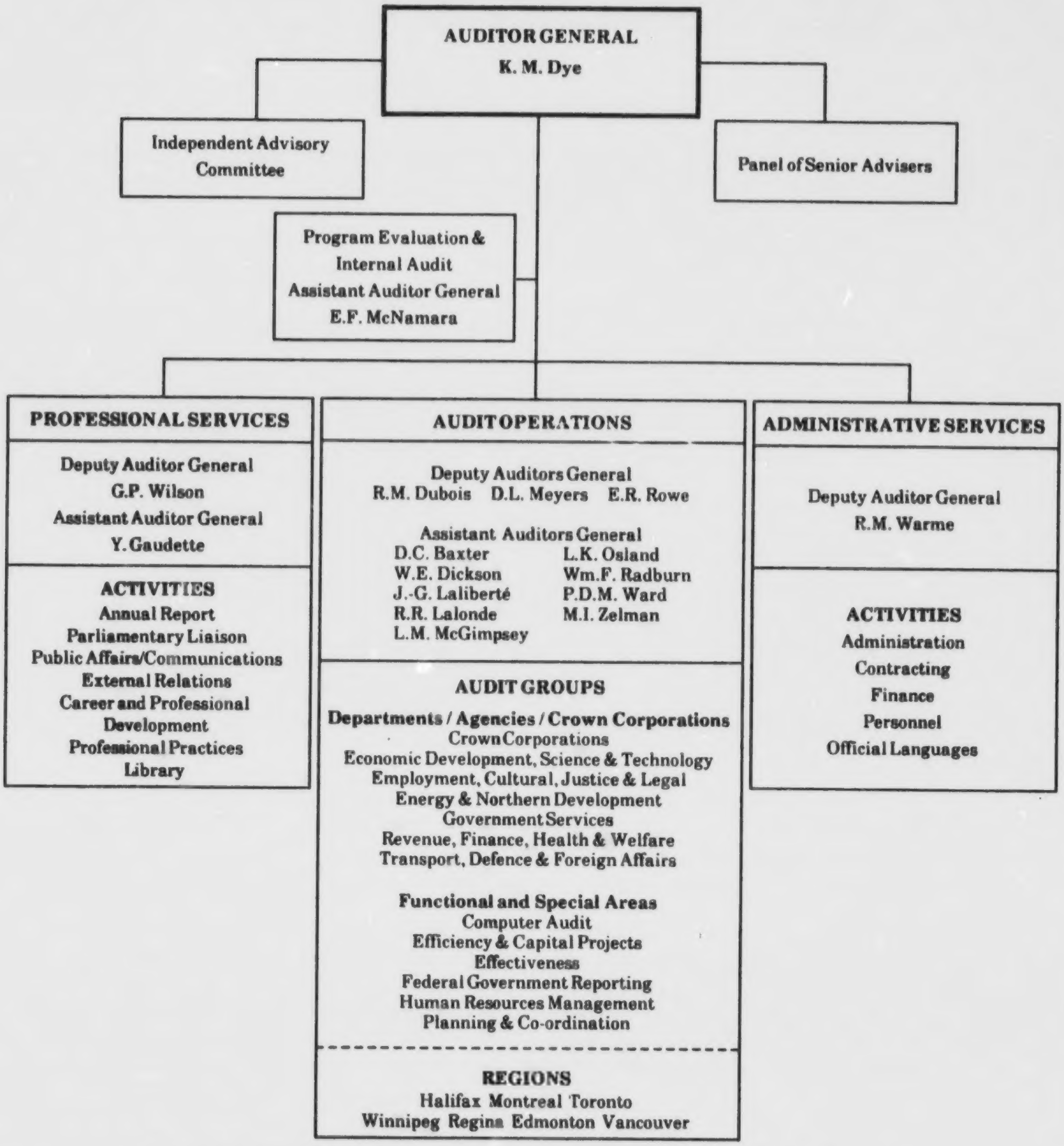
15.5 Overall direction of the Office and planning remain with the Auditor General and the Executive Committee. This Committee comprises the Deputy Auditors General with the Auditor General as chairman.

15.6 The organizational chart, Exhibit 15.2, outlines the Office's organization as implemented on 4 September 1984. The major changes from the previous organization are as follows:

- The functional groups that were part of the Professional Services Branch have been moved to Audit Operations. These include:

Exhibit 15.2

ORGANIZATION OF THE OFFICE OF THE AUDITOR GENERAL
4 September 1984



AUDITOR GENERAL
K. M. Dye

Independent Advisory Committee

Panel of Senior Advisers

Program Evaluation & Internal Audit
Assistant Auditor General
E.F. McNamara

PROFESSIONAL SERVICES

Deputy Auditor General
G.P. Wilson
Assistant Auditor General
Y. Gaudette

ACTIVITIES
Annual Report
Parliamentary Liaison
Public Affairs/Communications
External Relations
Career and Professional Development
Professional Practices
Library

AUDIT OPERATIONS

Deputy Auditors General
R.M. Dubois D.L. Meyers E.R. Rowe

Assistant Auditors General
D.C. Baxter
W.E. Dickson
J.-G. Laliberté
R.R. Lalonde
L.M. McGimpsey
L.K. Osland
Wm.F. Radburn
P.D.M. Ward
M.I. Zelman

AUDIT GROUPS

Departments / Agencies / Crown Corporations
Crown Corporations
Economic Development, Science & Technology
Employment, Cultural, Justice & Legal
Energy & Northern Development
Government Services
Revenue, Finance, Health & Welfare
Transport, Defence & Foreign Affairs

Functional and Special Areas
Computer Audit
Efficiency & Capital Projects
Effectiveness
Federal Government Reporting
Human Resources Management
Planning & Co-ordination

REGIONS
Halifax Montreal Toronto
Winnipeg Regina Edmonton Vancouver

ADMINISTRATIVE SERVICES

Deputy Auditor General
R.M. Warme

ACTIVITIES
Administration
Contracting
Finance
Personnel
Official Languages

The Executive Committee is composed of the Auditor General and the Deputy Auditors General.

  - Human Resource Management (formerly called Payroll Costs Management);
  - Efficiency and Capital Projects (formerly Control Evaluations);
  - Computer Audit; and
  - Effectiveness.
- The functions of Professional Services have been changed to incorporate the Executive Office, the Library, Career and Professional Development, and Standards, Research and Methodology.
- The Audit Groups within Audit Operations have been modified.

Audit Operations

15.7 The Audit Operations Branch is the largest component, reflecting the major thrust and work of the Office. It plans and conducts audits of federal departments and agencies and of other entities for which the Auditor General is the appointed auditor.

Departments, Agencies and Crown Corporations

15.8 The activities of the Audit Operations Branch include audits of government departments and agencies, audits of Crown-owned corporations, and government-wide audits and other studies.

15.9 To audit departments and agencies, the Branch is organized internally into Audit Groups. Each group audits departments which have a strong program interrelationship and which are, in many instances, linked to the same budgetary envelopes.

15.10 This concentration by area provides greater continuity in the audit process and improved understanding of issues, resulting in better relationships with client entities.

15.11 The responsibility for government-wide audits and other studies, together with any special audits, is shared among all the Audit Groups.

15.12 The **Crown Corporations group** is responsible for providing direction and advice on general accountability issues relating to Crown corporations and other entities and for analysing the impact on the Office of the passage of the amendments to the Financial Administration Act with respect to Crown-owned corporations, in terms of policy and methodology development, operational considerations and co-ordination and liaison. Its reporting standards unit focuses on reviewing audit reporting in order to provide advice to the Auditor General and to staff with a view to ensuring greater consistency and efficiency in audits conducted by the Office in Crown corporations and other entities. In addition, the group is responsible for carrying out audits in a number of selected Crown corporations.

Functional and Special Areas

15.13 The **Computer Audit group** provides expertise and methodology in assessing whether value for money has been achieved in expenditures on electronic data processing and in the evaluation of financial controls in computerized systems within the government. The group has five activities:

- to provide EDP audit expertise to support the Office's financial audit work; for example, the attest opinion given by the Office on the Government's financial statements and those of some Crown corporations, and the assessment of the adequacy of financial controls in EDP-based systems in the government;
- to provide facilities and expertise to the Office in the areas of sampling methodology and computer audit software;
- to provide the value-for-money component for EDP management matters in departmental and government-wide audits;
- to identify and carry out investigations of suitable government-wide topics in the field of EDP; and
- to provide support to microcomputers used in the Office.

15.14 The **Efficiency and Capital Projects group** provides professional specialist advice and assistance to audit teams. This is achieved by ensuring that qualified staff are assigned to audits, maintaining an inventory of consultants capable of providing necessary services, providing functional guidance during the audit, and performing a quality control function. The group develops approaches to auditing efficiency and productivity in the government environment. In addition, the group provides expertise in the specific area of capital projects, assisting in the fulfilment of the Auditor General's commitment to audit such projects whenever the cost exceeds $ 100 million.

15.15 The **Effectiveness Audit group** is responsible for advising and assisting audit teams to assess the degree to which departments and agencies have satisfactory procedures in place to measure and report on the effectiveness of their programs. This is done in two ways: the staff of the group carry out audit work on effectiveness as members of audit teams; or, when necessary, the group will ensure that qualified consultants are supplied to the audit. Additionally, the group is responsible for quality control on all effectiveness audit work done by the Office, for developing and publishing effectiveness audit methodology, and for planning, conducting, and reporting government-wide audits of effectiveness measurement and reporting.

15.16 The **Federal Government Reporting group** is responsible for auditing the Public Accounts, for audit work related to Part IIIs of the Estimates, and matters involving the government's reporting of financial information. At present, the group is specifically responsible for the Federal Government Reporting Study.

15.17 The **Human Resource Management group** addresses value-for-money issues in the management of human resources in government departments and agencies. Its responsibilities include developing audit techniques and methodology and conducting government-wide studies that address service-wide management issues including central agency policies and directives, their impact on departmental and agency operations and departmental human resource management practices. The group also provides staff or consultants, functional direction and quality control to the human resource management components of audits. As an integral part of the comprehensive audit, the work examines human resource management controls and systems and their impact on the entity's capacity to deliver its programs.

15.18 The **Planning and Co-ordination group** is responsible for strategic and operational planning and for management services in the Audit Operations Branch. The group's major responsibility is to develop the planning, budgeting, organizational and administrative framework for Audit Operations.

15.19 The **Regional Office Audit groups** are, to a large extent, stand-alone operations. The groups represent the Auditor General in a regional environment. They plan, conduct and report on audits of entities with head offices in their respective regions and also contribute to the development of national audit plans for decentralized departments, agencies and Crown corporations. As well, they participate in departmental and government-wide audits and other studies.

15.20 The Audit Operations Branch consists of approximately 350 auditors, together with support staff. It accounts for about 63 per cent of the Office's human resources. Its staff is employed in Ottawa and in regional offices in Halifax, Montreal, Toronto, Winnipeg, Regina, Edmonton and Vancouver.

15.21 The Branch is responsible for auditing over 150 entities, covering the 10 major expenditure areas. During the year ended 31 March 1984, the Branch also performed the audits necessary for the Auditor General to express an opinion, as either the auditor or joint auditor, on the accounts of a number agency and proprietary Crown corporations, in accordance with section 77 of the Financial Administration Act, and of departmental Crown corporations and other entities. In addition, the Branch audits the accounts of the Governments of Yukon and the Northwest Territories and their agencies. As well, it performs the audit required by the Auditor General in his capacity as the external auditor of the International Civil Aviation Organization.

15.22 Audit Operations is responsible for the audit assignments of students on the staff who are enrolled in programs leading to the designation of Chartered Accountant, Certified General Accountant or Registered Industrial Accountant. During these assignments, students receive the practical experience needed to meet requirements for professional accreditation.

OAG audits the accounts of the Yukon Territory.

15.23 Audit Operations staff are regularly called on to participate in special projects. These include international audits, development of audit methodology, financial and administrative tasks, and professional development courses.

Professional Services

15.24 The Office re-organization brought together into the Professional Services Branch certain activities which support the work of Audit Operations. These include editing and producing the annual Report, liaising with Parliament, communicating internally and externally, and providing professional and career development. Professional Services is also involved in establishing audit policies, developing methodology, carrying out ongoing research, and maintaining the Office's Library.

15.25 The **Reports group** is responsible for editing and producing reports to Parliament and for providing reporting guidelines to audit teams and editorial advice to staff writing material for internal and external distribution. The annual Report of the Auditor General to the House of Commons is the principal product of the Office and is subject to central review, edit and technical verification by the Reports group.

15.26 The **Parliamentary Liaison group** co-ordinates the Office's relations with Parliament and the Public Accounts Committee (PAC) of the House of Commons. This involves preparing for PAC hearings and assisting Committee members and staff. The group also helps ensure that reports to Parliament meet the information needs of PAC members as they fulfil their responsibility of overseeing the expenditure of public funds.

15.27 The **Public Affairs and Communications Advisory groups** are responsible for the Office's internal and external communications. These include relations with the media, responding to inquiries from the public, and producing Office publications. A recent initiative has been the production and publication of the Office's bi-monthly magazine, Opinions.

15.28 The responsibilities of the **Career and Professional Development group** include designing, developing and delivering training and development courses for all Office staff in both official languages, and providing assistance in career planning and related counselling services. During the year, the group provided some 2,354 training days internally and 957 training days in courses outside the Office. There were 38 in-house training courses for professional and administrative staff. The group is also responsible for the Office's integrated career planning and development policy.

15.29 The **Professional Practices group** is responsible for developing and maintaining auditing policies, managing auditing methodology development, and conducting auditing research. During the year, the group has developed and published six Audit Guides dealing with auditing electronic data processing, auditing the planning function, and auditing the Public Accounts, among others. Several Accounting and Auditing Bulletins were also published. The Bulletins are designed to keep staff up to date on accounting and auditing matters. This methodology is shared with other legislative auditors in Canada and around the world. Auditing policies and procedures are assessed periodically with resulting changes communicated to staff, and auditing research is conducted to develop ways to improve audits. One of the group's major projects, nearing completion, is an extensive revision of the Office's *Comprehensive Auditing Manual*.

15.30 The Professional Services Branch is responsible for a number of matters of direct personal concern to the Auditor General. These include legal matters, relations with provincial Auditors General and relations with institutes and associations in the accounting and management consulting professions. The Branch also looks after the international activities of the Office. These are described in more detail later in this chapter.

15.31 The **Library** contains a collection of auditing and accounting material, Canadian parliamentary and government documents and publications, federal and provincial reports, and national and international publications and periodicals in fields related to the Office's mandate and responsibilities. The Library also has a computerized literature searching capability and, through contracts with five major data base vendors, access is available to well over 200 data bases covering all major fields in the social sciences,

sciences and arts. The Auditor General encourages the use of the Library by private sector accounting and auditing firms engaged in auditing Crown-owned entities.

Administrative Services

15.32 The Administrative Services Branch provides all other central support services in the Office. It is responsible for and provides advice on working with applicable administrative, contracting, financial, official languages and personnel policies. Its services are offered through five groups.

15.33 The **Administration group** provides support services including mail and messenger, office supplies and equipment, file maintenance, word processing, audio-visual, graphics, accommodation, telecommunications, receptionists and security personnel.

15.34 The **Contract Administration group** negotiates and monitors all contracts for engaging people from the private sector, including those who are brought into the Office for assignments of up to two years under the Public Service Commission's Interchange Canada program.

15.35 The **Comptroller's group** is responsible for, and provides advice on, the financial planning and reporting of the Office's resource requirements, providing electronic data processing services and systems development, and establishing procedures, systems and controls for managing the financial administration activities of the Office.

15.36 The **Personnel group** develops and administers personnel policies, practices and programs. These include staffing, classification, compensation and benefits, staff relations and human resource planning. From time to time, this group also assists the Office in government-wide audits of human resource management.

15.37 The **Official Languages group** advises senior management on interpretation of government official languages policies as they apply to the Office and develops and implements the Office's official languages policies and programs.

Program Evaluation and Internal Audit

15.38 The Program Evaluation and Internal Audit function reports direct to the Auditor General.

15.39 Program Evaluation examines the effectiveness of the Office's work in terms of its usefulness in assisting the House of Commons in the scrutiny of government programs, revenues and expenditures. The evaluation involves analysing the use made of the annual Report by the Public Accounts Committee and other Committees of the House. As well, periodic interviews are held with Members of Parliament to obtain their views on the usefulness of the information provided in the annual Report and to solicit suggestions on how the Report could be improved. Finally, post-audit quality review is carried out to ensure that the work of the Office meets the highest professional standards.

15.40 Internal Audit assesses the economy, efficiency and effectiveness of the Office's internal management policies, practices and controls.

Advisers to the Auditor General

15.41 The **Panel of Senior Advisers** counsels the Auditor General on the application of comprehensive auditing, with particular emphasis on public sector corporate entities. Members of the Panel are:

- Kenneth G. Belbeck, F.M.C.
  President
  Thorne Stevenson & Kellogg
  Toronto
- H. Marcel Caron, F.C.A.
  Associate
  Clarkson Gordon
  Montreal
- Warren Chippindale, F.C.A.
  Chairman & Chief Executive Partner
  Coopers & Lybrand
  Toronto
- Gordon H. Cowperthwaite, F.C.A.
  Chairman
  Canadian Comprehensive
  Auditing Foundation
  Ottawa
- Frank A. Hughes, C.A.
  Chairman Partner
  Campbell Sharp
  Toronto
- Giles R. Meikle, F.C.A.
  Senior Partner
  Deloitte Haskins & Sells
  Toronto
- Edward W. Netten, C.A.
  Managing Partner
  Price Waterhouse Associates
  Toronto
- John Palmer, C.A.
  Executive Partner
  Thorne Riddell
  Toronto
- Robert M. Rennie, F.C.A.
  Chairman of the Board
  Touche Ross & Co.
  Montreal

15.42 The **Independent Advisory Committee on Government Accounting and Auditing Standards** comprises senior representatives of accounting firms, management consulting firms, and the academic community. The Committee reviews major documents such as the opinion and observations on the annual financial statements of the Government and the Office's *Comprehensive Auditing Manual* and Audit Guides. Members are:

- Ronald G. Gage, F.C.A.
  Partner
  Clarkson Gordon
  Toronto

- James L. Goodfellow, C.A.
  Partner
  Touche Ross & Co.
  Toronto

- John J. Kelly, C.A.
  Canadian Institute of
  Chartered Accountants
  Toronto

- Patrick D. Lafferty, C.A.
  Partner
  Coopers & Lybrand
  Ottawa

- Alwyn D. Lloyd, C.A.
  Senior Partner
  Lloyd Courey & Bruneau
  Montreal

- P. Howard Lyons, F.C.A.
  Partner
  Deloitte Haskins & Sells
  Toronto

- Michael H. Rayner, F.C.A.
  Partner
  Price Waterhouse Associates
  Ottawa

- Ronald B. Robinson, F.M.C.
  Partner
  Thorne Stevenson & Kellogg
  Toronto

- Professor L.S. Rosen F.C.A.
  Faculty of Administrative
  Studies
  York University
  Toronto

- William R. Sloan, F.C.A.
  (Chairman)
  Partner
  Arthur Andersen & Co.
  Ottawa

- George L. Stephenson, F.C.A.
  Partner
  Thorne Riddell
  Toronto

Reporting Responsibilities

15.43 Four sections in the Auditor General Act detail the Auditor General's responsibility to report to Parliament. Section 6 requires the Auditor General to express an opinion on the financial statements of the Government of Canada. Section 7 requires the Auditor General to report annually to the House of Commons anything that he considers to be of significance and of a nature that should be brought to its attention. This includes cases where public funds have been expended without due regard to economy or efficiency, or where procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented. Section 8 enables the Auditor General to make a special report to the House of Commons on any matter of pressing importance or urgency that, in his opinion, should not be deferred until the annual Report is tabled. Finally, section 11 permits the Auditor General to inquire into and report on matters in response to requests from the Governor in Council.

Public Accounts Committee

15.44 Following the tabling of the annual Report by the Speaker of the House of Commons, the Report is referred for more detailed study to the Public Accounts Committee (PAC). In connection with the 1983 Report, the Auditor General, together with members of his staff, attended 14 PAC meetings.

15.45 In addition, the Auditor General appeared four times before the Committee on Miscellaneous Estimates and was also a witness at the Senate Committee on National Finance.

International Activities

15.46 Canada has acquired a wide reputation in public sector auditing that is recognized by countries and organizations around the world. The Office's work is also well known and respected by the Internal Organization of Supreme Audit Institutions (INTOSAI), where the Auditor General serves on the governing board; the United Nations, where Canada is on the Panel of External Auditors and the Auditor General of Canada is chairman; NATO, where we have a representative on the Board of Audit; and the association of Commonwealth Auditors General.

Delegation from the Peoples' Republic of China with Deputy Auditor General G. Peter Wilson and officials of Ontario Hydro. (Photo courtesy of Ontario Hydro.)

15.47 Since 1982, the Office has been involved in an international effort with CIDA, the United Nations and the Peoples' Republic of China to assist the Peoples' Republic in developing the legislative audit function called for in its new constitution. In May 1984, the Office received a delegation of seven senior auditors from the Peoples' Republic, headed by Madam Qi Tian, Deputy Auditor General. In addition to intensive training and discussion sessions in the Office, the delegation met with parliamentarians and visited a number of other organizations.

15.48 The Office continues to be involved in international assignments. Canadian auditors are working with the Asian Development Bank in Manila, the NATO Board of Audit in Brussels, and the United Nations Economic Commission for Africa, in Addis Ababa. In 1983-84, the Office entered into an exchange with the National Audit Office of the United Kingdom; a senior auditor of that Department worked in the Office of the Auditor General in Ottawa while one of the Office's Principals worked for the year in London.

15.49 The Office helps to support the international community through the International Audit Office Assistance Program. Announced in the United Nations in the fall of 1979, the program is designed to help auditors from developing nations upgrade their public sector auditing skills and techniques, especially through the practice of value-for-money auditing. The program is a Canadian initiative, funded by the Canadian International Development Agency and administered by the Canadian Comprehensive Auditing Foundation. There is a training component and a fellowship program.

15.50 Through the training arm of the program, a seminar on Comprehensive Auditing was presented in Tunis for French-speaking countries that are members of ARABOSAI, the Arab region of the International Organization of Supreme Auditing Institutions.

15.51 The fellowship component of the program provides one-year assignments in the Audit Office for senior auditors from around the world. To fellowship graduates from Chile, Colombia, Ghana, Kenya, Malaysia, Nepal, Peru, Philippines, Singapore, Sri Lanka, St. Lucia, Tanzania, Thailand, Trinidad and Tobago were added this year's graduates from Belize, Dominica, Indonesia, Jamaica, Nigeria, Pakistan, Peoples' Republic of China, Tanzania and Uganda. The 1984-85 fellows are from Brazil, Kenya, Korea, Malaysia, Mexico, Nigeria, Sri Lanka and Trinidad and Tobago.

15.52 The program is achievement oriented, extending beyond formal and on-the-job training experience into follow-up by Canadian advisers when Fellows return home to apply their newly acquired expertise.

15.53 Among recent international visitors to the Office have been:

- Miguel Rico, Auditor General of Mexico;

- Hugh Marsh, Chairman of the Board of the International Institute of Internal Auditors;
- The Rt. Hon. Peter Rees, P.C., Q.C., M.P., Chief Secretary to the Treasury, United Kingdom;
- J.R.P. Dumas and Gordon Draper of the Public Service Review Task Force of Trinidad and Tobago;
- Madam Qi Tian, Deputy Auditor General of the Peoples' Republic of China;
- Jack O'Donnell, Auditor General of New South Wales;
- A.O. Osoba, Auditor General of Nigeria;
- B.H.C. Tyler, Controller and Auditor General of New Zealand.

The Canadian Comprehensive Auditing Foundation

15.54 The Office continues to be a major contributor to the activities of the Canadian Comprehensive Auditing Foundation. The Foundation is a national non-profit organization, established to encourage the development of methodology and professional development programs in comprehensive auditing. An association of public and private sector auditors, accountants and management consultants, international auditors in the public and private sectors, and academics, the Foundation operates as a co-operative agency for audit research and as a forum for exchanging and disseminating information among members. Members of the Foundation include institutions and professional organizations such as legislative audit offices, government and private sector internal audit groups, public accounting and management consulting firms, individuals and corporations. The Foundation is financed by contributions from the federal and provincial legislative audit offices and by fees paid by the various sustaining, subscribing and individual members.

Canadian Conference of Legislative Auditors

15.55 The Office maintains an active role in the Canadian Conference of Legislative Auditors, attended each year by the federal and provincial auditors, together with their deputies and the chairpersons of provincial and territorial public accounts committees. The Conference, held in Charlottetown, Prince Edward Island in 1984, plays an important part in improving governmental accountability in Canada.

Human Resources

15.56 The growing complexity of government operations, the sophistication of modern accounting systems and audit techniques and the changing and expanding responsibilities of the Audit Office require a skilled staff of high quality. The Office recruits and develops highly qualified people in accounting and auditing. In addition, the special requirements of comprehensive audits and government-wide studies require professionals drawn from a variety of other fields and disciplines, including engineering, sociology, economics and political science.

15.57 The following table presents a profile of the full-time staff of the Office.

	31 March 1984	31 March 1983
Principals	69	59
Directors and Managers	103	105
Supervisors and Auditors	154	146
Other audit staff	62	68
Administrative support staff	186	158
	574	536
National Capital Region	475	441
Other Regions	99	95
	574	536

15.58 The Office continues to make use of private-sector professionals on personal service contracts or through the Public Service Commission's Interchange Canada program. These professionals provide the Office with specialized knowledge and experience not required on a full-time basis. Over the years, the Office has found this assistance to be cost-effective with benefits for both the private-sector professionals and the Office staff. As of 31 March 1984, the Office had 10 participants under the Interchange Canada program and 257 persons engaged under personal services contracts. During the year, private-sector individuals provided about 74 person-years of professional service.

Women in the Office

15.59 The Office continues to move closer to fulfilling its equal opportunity goal, set out in 1977, "...to provide career opportunities which are equally available to women and men throughout our organization to ensure that, within a reasonable period of time, representation of male and female employees of the Office approximates the proportion of qualified and interested persons of both sexes by occupational group and level."

15.60 During 1983-84, 80 persons were hired into the Office; 35, or 44 per cent, were women. Of 18 students-in-accounts recruited, 10 were women. Throughout the Office, 99 people were promoted. Of these, 52 were women, 28 in the professional categories, 24 in support groups. Fifteen women were appointed to permanent positions from term. Twenty-two women progressed in the Students-in-Accounts Program.

Official Languages

15.61 The Auditor General's objective of having a fully functional bilingual Office moved substantially closer during the year. Ninety employees participated in the Office's in-house French language training and development workshops; seven were completing full-time training; three were enrolled in the Public Service Commission's evening courses; and three were participating in other intensive language sessions. The Language Knowledge Examination was administered to 58 staff members. In English-language training three employees were enrolled in intensive programs and four in part-time studies.

15.62 The Commissioner of Official Languages reported that

> in 1983 the Office of the Auditor General of Canada consolidated a number of the gains noted in our last Report. It increased its capacity to serve the public and its client departments in their preferred language, raised the number of senior positions that require bilingual capability and mounted a comprehensive language-training program. However, it was less successful in correcting the perpetual problem of low francophone representation in the executive ranks. Professional development courses are offered in English and French. Staff are encouraged to use either language at meetings and have the option of working in French in the two headquarters units set up for that purpose. The performance review process, which so far has not taken employees' linguistic preferences into account, is currently under study. Overall the participation rates of the two language groups remain constant (70 per cent anglophone, 30 per cent francophone). The Office's efforts to increase francophone participation through recruitment have been successful: 35 per cent of the 109 new employees in 1983 were francophones.

Employment for the Handicapped

15.63 It is the policy of the Office of the Auditor General to provide to handicapped persons equal access to employment and career development, according to the skills and abilities of individuals, in positions for which they are considered to be qualified, and to ensure that any barriers to such access, whether procedural, attitudinal or physical, are eliminated. During the 1983-84 fiscal year, action was under way to ensure that all handicapped employees in the Office have access to or are provided with services and/or equipment to facilitate the conduct of their duties. To achieve this objective, the help of all currently employed handicapped persons in the Office was sought to determine the types of assistance required and to provide it.

Deaths and Retirements

15.64 During the year, the Office was saddened by the deaths of Marcel Ferland, Deputy Auditor General, who served in the Office for 7 years; and Keith Abel, who had served as an Audit Supervisor for 11 years.

15.65 Members of the Audit Office retiring in the year ended 31 March 1984 (with their length of public service) included:

- Frank Matthews, Audit Director (19 years);
- Stanley M. Toporowski, Senior Auditor (21 years);

Exhibit 15.3

OFFICE OF THE AUDITOR GENERAL OF CANADA
APPROPRIATIONS AND EXPENDITURES

Appropriations and Expenditures by Activity

	1984-85	1983-84		1982-83	
	Estimates	Appropriations	Expenditures	Appropriations	Expenditures
			(thousands of dollars)		
Legislative Auditing	40,604	38,806	37,512	35,549	34,098
TOTAL	40,604	38,806	37,512	35,549	34,098

Appropriations and Expenditures by Object

	1984-85	1983-84		1982-83	
	Estimates	Appropriations	Expenditures	Appropriations	Expenditures
			(thousands of dollars)		
Salaries and Wages	26,567	23,249	22,848	19,749	20,088
Contributions to Employee Benefit Plans	3,369	3,223	3,223	2,838	2,838
Transportation and Communications	2,600	2,400	2,535	1,615	2,506
Information	110	139	123	95	78
Professional and Special Services	6,527	8,298	6,747	9,981	6,648
Rentals	246	464	220	332	410
Purchased Repair and Upkeep	105	70	163	22	117
Utilities, Materials and Supplies	485	500	569	525	462
Capital-Construction or Acquisition of Machinery and Equipment	220	73	743	67	612
Grants and Contributions	363	339	337	320	381
All Other Expenditures	11	51	4	5	21
TOTAL	40,604	38,806	37,512	35,549	34,098

- Ian Buzza, Director (23 years); and
- William Yusak, Audit Director (36 years).

Technical Resources

15.66 The nature of auditing is changing. Whether in the public or private sector, computer-assisted auditing is an essential tool. Microcomputers are now extensively used by auditors throughout the Office. As well, the Career and Professional Development group provides a number of training sessions in the application of electronic data processing to audit activities.

15.67 The Computer Audit group is linked to a large service bureau for our work in Computer Assisted Audit Techniques (CAAT). About half the Office's CAAT work is done through this service bureau, with the remainder being done on large departmental computers.

15.68 A minicomputer system is used in the complex task of deploying the staff of the Office economically, efficiently and effectively. In addition to supporting time reporting and contracts, the system processes the Office's priority resource allocation and management system and the career and professional development management information system.

15.69 The demands of producing the annual Report and the other reports of the Office have resulted in the development of a sophisticated word processing capability. Word processing at Head Office is done in both central and decentralized areas. Text processing is provided by work stations connected by local area network to a laser printer, resulting in a sophisticated and powerful graphics preparation and text integration capability which permits, for example, the complete text processing of the annual Report, the *Comprehensive Auditing Manual* and Audit Guides. Word processors in the Montreal and Edmonton offices transmit and receive documents, improving the communication capability between Head Office and the regions.

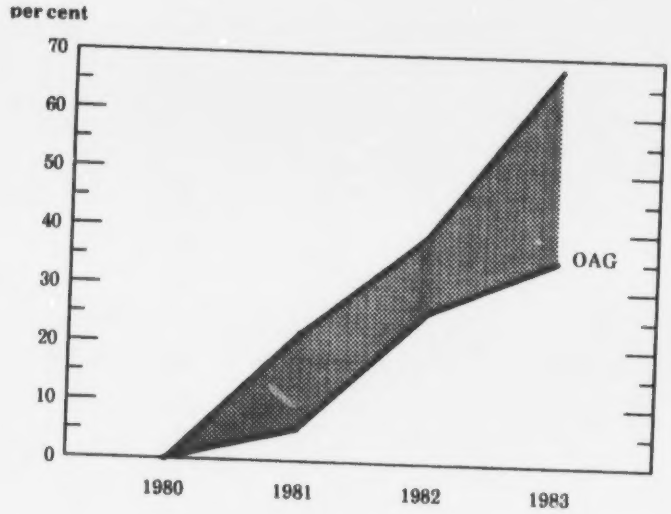
Financial Resources

15.70 Exhibit 15.3 sets out the appropriations and expenditures of the Office, by activity and by object.

15.71 The actual expenditures by the Office, in relation to the financial transactions of the government that the Office audits, continue to show a decline: see Exhibit 15.4.

Exhibit 15.4

VALUE AUDITED RELATED TO OAG EXPENDITURES



(Cumulative Percentage Increase from Base Year 1980.)

15.72 The value being audited, contrasted with the Office's expenditure, represents both a timely reminder of the immensity of federal government financial activity and the value for money provided by the Audit Office in helping to ensure the accountability of the Government.

APPENDICES

APPENDICES

TABLE OF CONTENTS

Appendix **Page**

A. AUDITOR GENERAL ACT A-1

B. FINANCIAL ADMINISTRATION ACT - EXTRACTS FROM PART VIII B-1

C. REPORTS OF THE STANDING COMMITTEE ON PUBLIC ACCOUNTS TO THE HOUSE OF COMMONS C-1

APPENDIX A

AUDITOR GENERAL ACT

25-26 ELIZABETH II

CHAPTER 34

An Act respecting the office of the Auditor General of Canada and matters related or incidental thereto

[*Assented to 14th July, 1977*]

Her Majesty, by and with the advice and consent of the Senate and House of Commons of Canada, enacts as follows:

PART I

SHORT TITLE

Short title 1. This Part may be cited as the *Auditor General Act*.

INTERPRETATION

Definitions 2. In this Act,

"Auditor General" "Auditor General" means the Auditor General of Canada appointed pursuant to subsection 3(1);

"Crown corporation" "Crown corporation" has the meaning assigned to that expression by subsection 66(1) of the *Financial Administration Act*;

"Department" "Department" has the meaning assigned to that term by section 2 of the *Financial Administration Act;*

"Registrar" "Registrar" means the Bank of Canada and a registrar appointed under Part IV of the *Financial Administration Act*.

AUDITOR GENERAL OF CANADA

Appointment and tenure of office 3. (1) The Governor in Council shall, by commission under the Great Seal, appoint a qualified auditor to be the officer called the Auditor General of Canada to hold office during good behaviour for a term of ten years, but the Auditor General may be removed by the Governor in Council on address of the Senate and House of Commons.

Idem (2) Notwithstanding subsection (1), the Auditor General ceases to hold office on attaining the age of sixty-five years.

Re-appointment (3) Once having served as the Auditor General, a person is not eligible for re-appointment to that office.

Vacancy

(4) In the event of the absence or incapacity of the Auditor General or if the office of Auditor General is vacant, the Governor in Council may appoint a person temporarily to perform the duties of Auditor General.

Salary

4. (1) The Auditor General shall be paid a salary equal to the salary of a puisne judge of the Supreme Court of Canada.

- S.C. 1976-77, c. 34, s. 4(1);
- S.C. 1980-81-82-83, c. 50, s. 23;
- S.C. 1980-81-82-83, c. 55, s. 1.

Pension benefits

(2) The provisions of the *Public Service Superannuation Act*, other than those relating to tenure of office, apply to the Auditor General except that a person appointed as Auditor General from outside the Public Service may, by notice in writing given to the President of the Treasury Board not more than sixty days after the date of his appointment as Auditor General, elect to participate in the pension plan provided for in the *Diplomatic Service (Special) Superannuation Act* in which case the provisions of that Act, other than those relating to tenure of office, apply to him and the provisions of the *Public Service Superannuation Act* do not apply to him.

DUTIES

Examination

5. The Auditor General is the auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act.

Idem

6. The Auditor General shall examine the several financial statements required by section 55 of the *Financial Administration Act* to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have.

- S.C. 1976-77, c. 34, s. 6;
- S.C. 1980-81-82-83, c. 170, s. 25.

Report to House of Commons

7. (1) The Auditor General shall report annually to the House of Commons

(a) on the work of his office; and,

(b) on whether, in carrying on the work of his office, he received all the information and explanations he required.

Idem

(2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that

(a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

(*b*) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;

(*c*) money has been expended other than for purposes for which it was appropriated by Parliament;

(*d*) money has been expended without due regard to economy or efficiency; or

(*e*) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

Submission of report to Speaker and tabling in the House of Commons

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before the 31st day of December in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receipt thereof by him or, if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting.

Special report

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in his opinion, should not be deferred until the presentation of his annual report.

Submission of reports to Speaker and tabling in the House of Commons

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 20(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting.

Idem

9. The Auditor General shall

(*a*) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require, and;

(*b*) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act*;

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities.

Improper retention of public money

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board.

Inquiry and Report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the public service of Canada of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board.

ACCESS TO INFORMATION

Access to information

13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his responsibilities and he is also entitled to require and receive from members of the public service of Canada such information, reports and explanations as he deems necessary for that purpose.

Stationing of officers in departments

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act*.

Reliance on audit reports of Crown corporations

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

Auditor General may request information

(2) The Auditor General may request a Crown corporation to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

Direction of the Governor in Council

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries access to which is, in the opinion of the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada.

STAFF OF THE AUDITOR GENERAL

Officers, etc.

15. (1) Such officers and employees as are necessary to enable the Auditor General to perform his duties shall be appointed in accordance with the *Public Service Employment Act*.

Contract for professional services

(2) Subject to any other Act of Parliament or regulations made thereunder, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his office in *Appropriation Acts*, contract for professional services.

Delegation to Auditor General

(3) The Auditor General may exercise and perform, in such manner and subject to such terms and conditions as the Public Service Commission directs, the powers, duties and functions of the Public Service Commission under the *Public Service Employment Act*, other than the powers, duties and functions of the Commission in relation to appeals under sections 21 and 31 of that Act and inquiries under section 32 of that Act.

Suspension

(4) The Auditor General may suspend from the performance of his duty any person employed in his office.

Responsibility for personnel management

16. In respect of persons employed in his office, the Auditor General is authorized to exercise the powers and perform the duties and functions of the Treasury Board under the *Financial Administration Act* that relate to personnel management including the determination of terms and conditions of employment and the responsibility for employer and employee relations, within the meaning of paragraph 5(1)(*e*) and section 7 of that Act.

Collective agreements

17. Any collective agreement affecting persons employed in the office of the Auditor General entered into before the coming into force of this Act remains in force and binds the Auditor General as employer of such persons until the expiry of that agreement.

Classification standards

18. Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office.

Delegation

19. The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 55 of the *Financial Administration Act* and his reports to the House of Commons under this Act and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General.

ESTIMATES

Estimates

20. (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.

Special report

(2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office.

Approbation allotments

21. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General.

AUDIT OF THE OFFICE OF THE AUDITOR GENERAL

Audit of office of the Auditor General

22. (1) A qualified auditor nominated by the Treasury Board shall examine the receipts and desbursements of the office of the Auditor General and shall report annually the outcome of his examinations to the House of Commons.

Submission of reports and tabling

(2) Each report referred to in subsection (1) shall be submitted to the President of the Treasury Board on or before the 31st day of December in the year to which the report relates and the President of the Treasury Board shall lay each such report before the House of Commons within fifteen days after receipt thereof by him or, if that House is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting.

PART II

CONSEQUENTIAL AND RELATED AMENDMENTS

R.S., c. F-10

23. Part VII of the *Financial Administration Act* is repealed.

R.S., c. P-35

24. (1) Part I of Schedule I to the *Public Service Staff Relations Act* is amended by deleting therefrom the words "Office of the Auditor General of Canada".

(2) Part II of Schedule I to the *Public Service Staff Relations Act* is amended by adding thereto the words "Office of the Auditor General of Canada".

R.S., c. E-8

25. Section 16 of the *Established Programs (Interim Arrangements) Act* is repealed and the following substituted therefor:

Powers of Auditor General

"**16.** Nothing in this Act shall be construed to restrict the powers of the Auditor General of Canada under the *Auditor General Act*."

1970-71-72, c. 52

26. Section 27 of the French version of the *Pilotage Act* is repealed and the following substituted therefor:

Vérificateur général

"**27.** Le vérificateur général vérifie chaque année la comptabilité et les opérations financières de chaque Administration et en fait rapport au Ministre."

R.S., c. N-22

27. Subsection 23(5) of the *Northwest Territories Act* is repealed and the following substituted therefor:

Powers of Auditor General

"(5) The Auditor General has, in connection with his examination of the accounts of the Territories, all the powers that he has under the *Auditor General Act* in connection with the examination of the accounts of Canada."

R.S., c. Y-2

28. Subsection 26(5) of the *Yukon Act* is repealed and the following substituted therefor:

Powers of Auditor General

"(5) The Auditor General has, in connection with his examination of the accounts of the Territory, all the powers that he has under the *Auditor General Act* in connection with the examination of the accounts of Canada."

1970-71-72, c. 48

29. Section 15 of the French version of the *Unemployment Insurance Act*, 1971 is repealed and the following substituted therefor:

Vérification

"**15.** Le vérificateur général vérifie chaque année la comptabilité et les opérations financières de la Commission et en fait rapport au Ministre."

Amendments to French version

30. Whenever, in the French version, the expression "auditeur général" appears in any provision of an Act listed in the schedule to this Act, there shall in every case, unless the context otherwise requires, be substituted the expression "vérificateur général".

PART III

COMMENCEMENT

Coming into force

31. This Act shall come into force on a day to be fixed by proclamation.

APPENDIX B

FINANCIAL ADMINISTRATION ACT

EXTRACTS FROM PART VIII

FINANCIAL ADMINISTRATION ACT

R.S., c. F-10

Extracts from Part VIII

CROWN CORPORATIONS

Access to books, etc.

76. The auditor is entitled to have access at all convenient times to all records, documents, books, accounts and vouchers of a corporation, and is entitled to require from the directors and officers of the corporation such information and explanations as he deems necessary. R.S., c. 116, s. 86.

Auditor's report

77. (1) The auditor shall report annually to the appropriate Minister the result of his examination of the accounts and financial statements of a corporation, and the report shall state whether in his opinion

(*a*) proper books of account have been kept by the corporation;

(*b*) the financial statements of the corporation

(i) were prepared on a basis consistent with that of the preceding year and are in agreement with the books of account;

(ii) in the case of the balance sheet, give a true and fair view of the state of the corporation's affairs as at the end of the financial year, and;

(iii) in the case of the statement of income and expense, give a true and fair view of the income and expense of the corporation for the financial year; and,

(*c*) the transactions of the corporation that have come under his notice have been within the powers of the corporation under this Act and any other Act applicable to the corporation;

and the auditor shall call attention to any other matter falling within the scope of his examination that in his opinion should be brought to the attention of Parliament.

Other reports

(2) The auditor shall from time to time make to the corporation or to the appropriate Minister such other reports as he may deem necessary or as the appropriate Minister may require.

Annual report

(3) The annual report of the auditor shall be included in the annual report of the corporation.

Audit

(4) Notwithstanding section 68, this section operates in lieu of section 132 of the *Canada Corporations Act* or sections 159 to 161 of the *Canada Business Corporations Act*, as the case may be.

Report through Minister

78. In any case where the auditor is of the opinion that any matter in respect of a corporation should be brought to the attention of the Governor in Council, the Treasury Board or the Minister of Finance, such report shall be made forthwith through the appropriate Minister. R.S., c. 116, s. 88.

APPENDIX C

REPORTS OF THE STANDING COMMITTEE ON PUBLIC ACCOUNTS TO THE HOUSE OF COMMONS

REPORT TO THE HOUSE

Monday, October 24, 1983

The Standing Committee on Public Accounts has the honour to present its

TWENTY-FIRST REPORT

1. In accordance with its permanent Order of Reference contained in the Standing Orders of the House of Commons, your Committee has considered Report of the Auditor General of Canada to the House of Commons for the fiscal year ended March 31, 1982 and, in particular, the following items:

A. Chapter 14 – Foreign Operations – the Comprehensive Audit of the Department of External Affairs (the Department); and

B. Paragraphs 15.4 and 15.5 – Audit Notes concerning the Canadian International Development Agency (CIDA).

2. The co-operation of the witnesses who appeared before your Committee is acknowledged and appreciated.

A–Comprehensive Audit of the Department of External Affairs

3. In light of the testimony it has received, concerning numerous cases of unacceptable management practices, your Committee wishes to bring to the attention of Parliament the general lack of concern exhibited by this Department for the proper management of public funds.

4. Your Committee heard testimony on the major issues arising from the comprehensive audit of the Department, with emphasis on:

(a) inadequacies in planning and financial management;

(b) deficiencies in personnel policies and practices; and

(c) inadequacies in management of accommodation abroad.

Inadequacies in Planning and Financial Management

5. The Auditor General informed your Committee that the Department had not developed modern planning practice. The Department explained its lack of strategic and operational planning in terms of senior officials' preference for an "ad hoc" approach to management. In light of the fact that many of the Department's activities (e.g., consular affairs and cultural relations) are amenable to planning, your Committee feels that such attitudes are wholly unacceptable. Your Committee notes that the Department is now implementing a "management plan"and an "operational planning framework". However, your Committee also noted the Auditor General's observation that the Department's planning initiatives had tended to be "paper exercises" – not used in decision-making. Your

Committee feels that the Department's senior officials must change their management philosophy and show a willingness to make use of strategic and operational plans.

6. Your Committee heard testimony on the Department's budgeting and review of expenditures. The Auditor General noted the following deficiencies:

(*a*) financial planning is inadequate, as a consequence of the lack of operational planning;

(*b*) financial reports are not appropriate to determine the required levels of expenditures;

(*c*) financial information is not regularly available to managers, to enable their involvement in the budgeting process; and

(*d*) budgets are based on the previous year's expenditures - not the tasks or activities to be carried out.

Your Committee expects the Department to correct these deficiencies.

7. With respect to other areas of financial management, your Committee noted that the Department had failed to implement the recommendations arising from the Auditor General's 1975 Financial Management and Control Study. The Department testified that it has established a task force on this subject, with a reporting date before the end of 1983. Your Committee feels that the Department's response has been unreasonably slow.

8. Your Committee was informed by the Department that financial management and internal audit had not enjoyed a high profile in departmental operations. Your Committee feels that such a situation undermines the implementation of the Auditor General's recommendations.

9. Your Committee heard from the Auditor General that the Department's internal audit and inspection functions had not been providing senior management with an independent appraisal of the economy and efficiency of departmental operations. Although the Department recently allocated more resources to internal audit and upgraded professional standards, your Committee notes the observation of the Office of the Comptroller General that the task is by no means complete. Your Committee expects the Department to report its progress in this area.

10. With respect to the Department's inadequacies in planning and financial management, your Committee notes a common problem of poor communications within the Departments. For example, the Auditor General found that individual bureaux operate to maximize their immediate objectives which may not always coincide with departmental objectives. Your Committee also heard that there was inadequate consultation between headquarters and heads of posts abroad on such matters as the preparation of strategic plans. Your Committee expects the Department to correct these deficiencies.

Deficiencies in Personnel Policies and Practices

11. Although the Department's most valuable resource is the quality of its workforce, your Committee notes that there are serious weaknesses in the Department's personnel planning, assignment, and training activities. In the area of personnel planning, the Auditor General informed your Committee that the Department had not adequately related its personnel requirements to the jobs that need to be done. The Auditor General also found that the assignment process is centralized at headquarters, without adequate consultation of posts abroad, with the result that persons were assigned to positions without ensuring that they met the qualifications of these positions. With regard to training, the Auditor General told your Committee that foreign service personnel typically received "on-the-job" training, with no systematic assessment of individual and group training needs. These deficiencies lead your Committee to doubt that the Department is meeting its personnel policy objective of having "the right person in the right place at the right time". Canada's foreign service deserves a better effort from this Department.

Inadequacies in Management of Accommodation Abroad

12. The Department testified that it does not always follow the Treasury Board manual governing property acquisition through lease or purchase because this manual has a "domestic orientation". Your Committee questions the right of the Department to break Treasury Board rules established for the protection of public funds. Where inadequacies exist in Treasury Board manuals because of special circumstances, your Committee feels that it is the joint responsibility of the Department and the Treasury Board Secretariat to negotiate more appropriate rules.

13. With respect to accommodation planning and the evaluation of the Department's needs in this area, your Committee heard from the Auditor General that the Department needs to:

(a) strengthen its processes for identifying accommodation needs;

(b) set priorities for accommodation projects;

(c) prepare feasibility studies; and

(d) evaluate projects when completed.

Although your Committee welcomes the Department's initial response to the Auditor General's recommendations, i.e., additional personnel to be devoted to property management, your Committee feels that these problems must be followed through with detailed plans of action. This would eliminate the constantly shifting priorities that the Auditor General found to be symptomatic of the Department's management of accommodation abroad.

14. Your Committee heard the Department explain its plan to cut rental costs in accommodation abroad through property purchase under its Long-Range Capital Program. Your Committee encourages this initiative. Your Committee also noted the Auditor General's finding that this Program was often not followed, with cases such as Lagos, Nigeria, where high rents are still being paid.

15. Your Committee heard testimony about a number of cases of serious mismanagement of Crown-owned property abroad, notably Rome, Tokyo and Dallas. Your Committee also heard from the Auditor General that the Department, in many instances, has managed its accommodation satisfactorily. However, your Committee cannot accept practices, such as those in evidence in the Dallas case, where public money was wasted on renovations to a property that was not worth purchasing in the first place.

B–Audit Notes Concerning CIDA

16. The Auditor General brought to your Committee's attention instances where financial controls in CIDA over advance payments to suppliers and contractors were inadequate. In particular, he noted that advances were made in one fiscal year that were not required until the next; that payments were made to contractors as much as 5 years in advance, which in effect were a form of long-term financing; that the monitoring of the accounting for advances was inadequate; and that CIDA exceeded Treasury Board's authorized limits for advances.

17. Your Committee noted CIDA's explanation that these advance payments were either made pursuant to special terms and conditions approved for CIDA by Treasury Board or were exempted from Treasury Board rules and regulations (e.g., in the case of contracts involving loans to sovereign countries). Although it welcomes CIDA's testimony on corrective measures to improve financial controls, your Committee is concerned about CIDA's inadequate monitoring of these advances. Your Committee also questions the appropriateness of the Treasury Board rules and regulations, including the specific exemptions obtained by CIDA, in light of the abuses uncovered by the Auditor General.

Recommendations

18. Your Committee recommends that:

(a) the report of the Department's task force include firm commitments on dates for the implementation of the Auditor General's recommendations on planning and financial management and that the Department advise your Committee of this timetable for implementation by March 31, 1984 (Paragraph 7);

(b) the Department improve its personnel planning and assignment system for foreign service officers, implementing the Auditor General's recommendations in this area, and report its progress in this regard to your Committee by March 31, 1984 (Paragraph 11);

(c) the Department and the Treasury Board Secretariat immediately negotiate more appropriate rules governing property acquisition, and report progress to your Committee by March 31, 1984 (Paragraph 12);

(d) the Department implement the Auditor General's recommendations on management of accommodation abroad and ensure that these recommendations are followed through with consistent, detailed plans of action for cost-effective acquisition and management of property and report progress to your Committee by March 31, 1984 (Paragraph 13);

(e) the Treasury Board Secretariat and CIDA review policy, regulations and procedures on advance payments (Paragraph 17);

(f) CIDA accord a high priority to improving its financial controls (Paragraph 17); and

(g) the Auditor General monitor CIDA's action, with respect to recommendations (e) and (f) above, and report his findings to your Committee no later than June 30, 1984 (Paragraph 17).

19. A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 80, 81, 82, 83 and 92 of the First Session of the Thirty-second Parliament*) is tabled.

Respectfully submitted.

Doug Lewis
Chairman

REPORT TO THE HOUSE

Thursday, November 17, 1983

The Standing Committee on Public Accounts has the honour to present its

TWENTY-SECOND REPORT
(The Canadair Report)

1. In accordance with its permanent Order of Reference contained in the Standing Orders of the House of Commons, your Committee has considered the Report of the Auditor General of Canada to the House of Commons for the fiscal year ended March 31, 1982 and, in particular, has considered paragraphs 10.95 to 10.100 inclusive; and vote 6(e) on page 13.4 of Volume II of the Public Accounts of Canada, 1981-1982, both concerning Canadair Limited.

2. The co-operation of the Honourable Jacob Austin, Minister of State for Social Development, and the other witnesses who appeared before your Committee is acknowledged and appreciated.

3. It should be strongly emphasized that your Committee, in its enquiry, did not question in any way the quality and technical achievements of the Challenger aircraft.

4. In June, 1983, your Committee held eight meetings and heard testimony from the Minister and officials responsible for Canadair Limited, a government-owned aircraft manufacturing company, concerning the circumstances surrounding the $1.4 billion loss incurred by the company.

5. This testimony exposed the roles and responsibilities of the auditors, and of the Government, and of Canadair's board of directors and management in approving and acquiring financial support for the Challenger program. Your Committee will outline in the following paragraphs its concerns with respect to the manner in which the various parties exercised these responsibilities. In so doing, your Committee does not seek to apportion blame, but rather to identify the deficiencies in the system of controls over Canadair in order that they can be improved in the future.

THE RESPONSIBILITIES OF THE GOVERNMENT

6. Your Committee has the following concerns about the Government's review and approval process in providing financial support to the Challenger program:

(a) role of Ministers;

(b) lack of objectives;

(c) shareholder's representation;

(d) inadequate accountability;

(e) inadequate monitoring;

(f) debt financing; and

(g) approval of letters of comfort.

(a) ROLE OF MINISTERS

7. Your Committee considers that Ministers who answer to Parliament for government-controlled corporations have the following responsibilities:

(i) to be aware of the corporation's activities [illegible] financial status;

(ii) to make significant policy decisions with respect to the Government's intentions;

(iii) to communicate these policy decisions and objectives to the corporation;

(iv) to ensure a competent board of directors and management; and

(v) to keep Parliament and the public informed on a timely basis of the corporation's activities and financial status.

8. Parliamentary practice prevented the Committee from hearing testimony from former Ministers of Industry, Trade and Commerce. However, senior public servants, who had served on Canadair's board, testified concerning their reports to Ministers; and your Committee concluded that Ministers were not consistently or adequately informed about the progress of the Challenger program. This leads your Committee to doubt that Ministers were able to make the decisions necessary to guide efficiently the development of the Challenger program. In your Committee's view, evidence given before your Committee reflected adversely on the role of successive Governments in ensuring that a competent board and management were continually in place at Canadair. Lastly, your Committee heard testimony that neither Parliament nor the public were adequately informed of Canadair's activities and financial status by the Ministers responsible. The financing by letters of comfort circumvented accountability to Parliament.

(b) LACK OF OBJECTIVES

9. Past directors testified that the shareholder did not provide them with a clear written statement of objectives until very late in the Challenger program, i.e. 1982.

(c) SHAREHOLDER'S REPRESENTATION

10. Your Committee has serious concerns about the significant part played by the shareholder's representatives both as directors on the board of the company and as public servants advising the Minister. This resulted in a conflict of duties, whereby:

(i) as directors, these public servants were instructed to represent their Minister's views; and

(ii) also, on behalf of the board, they were called upon to influence departmental officials to provide financial assistance to the company.

This conflict of duties, in your Committee's view, substantially weakened the objectivity of the board and its accountability to the shareholder. In addition, as Government representatives, they may have had a disproportionate influence on the decisions made by the board of directors.

(d) INADEQUATE ACCOUNTABILITY

11. As a result of the use of letters of comfort, Canadair's liabilities were underwritten by more than 1 billion dollars by the Government over a six-year period and thus were not revealed to Parliament until March, 1982. Because of this circumvention of the parliamentary process, Parliament and the public were not given adequate warning nor an earlier opportunity to consider the long-term financial viability of the Challenger program, nor were they properly informed of the impact of such a program on public expenditures. In addition to the use of letters of comfort, your Committee noted that the Government did not subject Canadair to the Financial Administration Act (FAA), which resulted in the following important deficiencies in Canadair's accountability to Parliament:

> *(i)* Canadair's financial statements were not tabled in Parliament nor published in Volume III of the Public Accounts and therefore not subject to review by parliamentary committees; and
>
> *(ii)* Canadair was not subject to more stringent reporting requirements, such as tabling of capital budgets by the appropriate Minister, under Section 70 of the FAA.

Your committee noted that management of the Canada Development Investment Corporation (CDIC) is prepared to make the financial statements of its subsidiaries available to Parliament as a matter of policy. It should also be noted that Bill C-158 specifically exempts Canadair and other CDIC subsidiaries from the provisions of the FAA.

(e) INADEQUATE MONITORING

12. In order to monitor Canadair, the Government had departmental reviews and established interdepartmental review committees and , from time to time, ad hoc task forces. Your Committee feels that this system was inadequate because:

> *(i)* the Department of Industry, Trade and Commerce did not have the capability to assess information provided by Canadair's management. Your Committee feels that the magnitude of public funds at risk in the Challenger program necessitated such a capability;
>
> *(ii)* the interdepartmental review committee of senior public servants, in place until April, 1981, reported to an Assistant Deputy Minister of the Department of Industry, Trade and Commerce serving on Canadair's board, rather than to the Minister; and
>
> *(iii)* reporting requirements equivalent to those of a Crown corporation under Schedule "C" to the FAA came too late, in February, 1982, to redirect the Challenger program and achieve significant savings.

(f) DEBT FINANCING

13. Your Committee heard testimony that debt financing was undertaken because "it was possible" and because of Canadair's previous experience on a limited basis with this form of financing. Your Committee feels that such attitudes did not demonstrate an adequate level of concern for the high financial risk associated with the Challenger program. Projects which involve new technologies, vaguely defined markets, and much uncertainty should be funded more appropriately with equity or direct subsidies.

(g) APPROVAL OF LETTERS OF COMFORT

14. Your Committee holds the view that the method of financing by letter of comfort shielded the Challenger program from a more objective, critical, parliamentary analysis. Canadair was put in a precarious position when record-high interest rates and the economic situation began to impact very seriously on the company.

RESPONSIBILITIES OF THE BOARD OF DIRECTORS

15. In providing your Committee with a commentary on the responsibilities of the board of directors, the Auditor General noted that the board should participate in the critical decisions of the organization and be accountable for them. He also noted that the board should enforce a discipline on management and evaluate its performance. Your Committee feels that Canadair's board of directors failed to exercise its responsibilities. For example:

(a) the directors failed to question management's plan to design and produce the Challenger in 30 months rather than the normal industry standard of 60 months;

(b) the directors did not challenge management early enough with regard to terms and conditions of specific sales, sales projections, and procurement contracts; and

(c) the directors missed opportunities to redirect management at critical stages of the Challenger program and simply adopted a passive role.

RESPONSIBILITIES OF CANADAIR'S MANAGEMENT

16. Your Committee has the following concerns about management's performance in the course of the Challenger program:

(a) management's lack of realism in attempting to design and produce this aircraft in 30 months when the industry standard is 60 months;

(b) management's failure to meet the Challenger's pre-sold specifications, by changing the original design concept of the plan and by failing to meet the Challenger 600's certification schedule: this added significantly to the costs of the program and caused major problems in marketing;

(c) management's conduct in terms of certain business practices. Your Committee heard testimony which raised questions about a number of sales contracts entered into by Canadair's management. In this regard, your Committee notes the lack of business shrewdness in the negotiation of sales and procurement contracts;

(d) management's preparation of the financial statements. Your Committee feels that these financial statements could have been prepared in a more explicit and straightforward manner. For example, management's financial statements in the years up to and including December 31, 1981 confused the reader; they did not clearly differentiate between program development costs associated with the Challenger and contract costs relating to long-term government and commercial contracts. This led one to conclude that the current asset item in the balance sheet was a deferred cost attributable to a contract or inventory item and not to a build-up of costs associated with the Challenger program. This, in your Committee's view, is contrary to the guidelines on deferred charges issued by the Canadian Institute of Chartered Accountants; and

(e) management's failure to be forthright with the board, the bureaucracy, the Government, and Parliament on the full range of available scenarios.

RESPONSIBILITIES OF THE AUDITORS

17. Your Committee has repeatedly brought to the attention of Parliament, in previous reports, its concerns with respect to the inconsistency of the statutory reporting responsibilities of auditors of government-controlled corporations. The auditors of unscheduled corporations, such as Canadair Limited, are subject only to the provisions of the Canada Business Corporations Act which call for an examination of the annual financial statements of the corporation and an audit report to the shareholders in accordance with generally accepted auditing standards. Under the FAA, auditors have additional obligations: they must report as to whether transactions of the corporation fall within the company's powers and furthermore, they must call the appropriate Minister's attention to any other matter falling within the scope of their examination that in their opinion should be brought to the attention of Parliament.

18. Your Committee heard detailed presentations from Thorne Riddell, the auditors of Canadair, on the conduct of their audit from 1979 to 1981 and on their responsibilities in reporting on Canadair's financial statements. Your Committee accepts the report of the auditors that their examination was made in accordance with generally accepted auditing standards and included such tests and other procedures as the auditors considered necessary in the circumstances.

19. In contrast to the auditors' report of The de Havilland Aircraft of Canada Limited for the year ended May 31, 1980, your Committee feels that the auditors of Canadair did not clearly bring to the shareholder's attention the significance of the deferred costs on the financial viability of the Challenger program and the company.

ROLE OF THE AUDITOR GENERAL

20. Your Committee noted that the role of the Auditor General, as Parliament's auditor, is to form an audit opinion on the financial statements of the Government of Canada. Canadair Limited, which is not audited by him, has incurred huge liabilities. The financing of these liabilities has a major impact on the expenditure of public funds, as does the magnitude of the liabilities on the Government's financial statements. Had the Auditor General been Canadair's auditor, his independence, objectivity, and mandate would have

enabled him to report not only to the shareholder, but also to Parliament, on the financial problems associated with the Challenger program.

RECOMMENDATIONS

21. Your Committee recommends that:

(a) When Crown corporations are used as a vehicle for Government policy, the Government must clearly enunciate that policy at the start of its implementation and clearly communicate it in writing to the board of directors and management of the Crown corporation (Paragraph 7);

(b) the Minister responsible for Canadair act upon his commitment to appoint additional directors to the board of directors, and in doing so ensure that people with expertise in the aircraft industry are included (Paragraph 7);

(c) no public servant with day-to-day departmental program responsibilities which impact upon Canadair should be appointed to the board of directors (Paragraph 10);

(d) the Government ensure that Letters of Comfort not be used in the future for financing on a long-term basis (Paragraph 14);

(e) all government-controlled corporations, including their subsidiaries, not at present scheduled under the FAA, such as Canadair, be scheduled and their financial statements reproduced in Volume III of the Public Accounts (Paragraph 11);

(f) the Government assess and report to Parliament, in Part III of the Estimates, the financing options open to it at the inception of each significant program or activity, funded or guaranteed by Government, to be undertaken by any government-controlled corporation, such as Canadair (Paragraphs 11 and 13);

(g) the Government finance through equity or direct subsidies projects which involve large expenditures, new technologies and high financial risk (Paragraph 13);

(h) the board of directors take immediate action to monitor the management of the Company in respect to the sales program and the evaluation, production and financing of the Challenger program (Paragraph 15);

(i) the Minister responsible report to your Committee by March 31, 1984 to ensure that all concerns raised by him and your Committee have been met;

(j) the Government give consideration to amending Section 77 of the FAA to require auditors of all government-controlled corporations to report to the Auditor General matters that in their opinion should be brought to the attention of Parliament (Paragraph 17);

(k) the Auditor General be entitled to participate on audit committees of Crown corporations and government-controlled corporations, such as Canadair, which are not audited by the Auditor General (Paragraph 20);

(l) when the auditors of government-controlled corporations have reported to the Auditor General matters that in their opinion should be brought to the attention of Parliament, the Auditor General be authorized to examine all relevant corporate records, auditors' reports and working papers of government-controlled corporations, such as Canadair (Paragraph 20); and

(m) the Auditor General be responsible for the establishment and maintenance of auditing standards for auditors of all government-controlled corporations, and to assure Parliament that such auditing standards are being complied with (Paragraph 20).

22. Your Committee requests that the Government respond to the foregoing recommendations in accordance with Standing Order 69 (13).

23. A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 85, 86, 87, 88, 89, 90, 91, 92 and 93 of the First Session of the Thirty-second Parliament*) is tabled.

Respectfully submitted.

Doug Lewis
Chairman

REPORT TO THE HOUSE

Tuesday, March 13, 1984

The Standing Committee on Public Accounts has the honour to present its

FIRST REPORT

1. In accordance with its permanent Order of Reference contained in the Permanent and Provisional Standing Orders of the House of Commons, your Committee has considered the following sections of the Public Accounts of Canada, Volume I, for the fiscal year ended March 31, 1983:

A – Section 2 - Audited Financial Statements of the Government of Canada; and

B – Section 3 - Observations by the Auditor General on the Financial Statements of the Government of Canada.

2. The co-operation of the witnesses who appeared before your Committee is acknowledged and appreciated.

3. Your Committee noted the observation of the Comptroller General that the Audited Financial Statements of the Government of Canada are in the forefront internationally in terms of financial disclosure and underlying accounting policies for national governments.

4. Your Committee heard testimony on the differences of opinion between the Comptroller General and the Auditor General on the underlying accounting policies and audit reservations to the financial statements. Your Committee also noted the Comptroller General's testimony as to his commitment to resolve the differences so that the Auditor General's reservations may be removed in the future. Your Committee urges both parties to settle their differences in order that the Canadian people can have the proper confidence in the Government's financial statements.

5. Your Committee feels there is a need for the Government to improve its method of reporting in the summary financial statements of the government of Canada. In this regard, the Auditor General called for improvements in the statement presentation of assets and liabilities and of revenues and expenditures. Your Committee noted the Comptroller General's commitment to complete his study to determine the purposes and objectives of the Government's financial statements.

6. Your Committee requests the Comptroller General, in his work on the financial statements, to address the following issues at the earliest possible opportunity:

(a) The Auditor General's reservations;

(b) the completion of his study of the purposes and objectives of the financial statements; and

(c) the presentation of financial statement information in accordance with its essential nature and substance.

(a) The Auditor General's Reservations

7. In its Thirteenth Report, dated March 22, 1982, and in earlier Reports to the House, your Committee recommended certain legislative amendments which would have the effect of removing the Auditor General's reservations to the Government's financial statements in the future. The Government has not acted on all of these recommendations. A recent amendment to the Financial Administration Act (Bill C-96, enacted in the First Session of the Thirty-second Parliament) gave the President of the Treasury Board and through him, the Comptroller General and the Minister of Finance the legal responsibility and authority for the improvement of government accounting. Your Committee believes that changes in government accounting are required in order to remove the Auditor General's reservations in the future.

(b) The Completion of the Comptroller General's Study

8. Your Committee endorses the Comptroller General's study of the purposes and objectives of the financial statements and agrees with the Government that important issues should be resolved on the basis of such a study. In a letter to your committee in April, 1982, the President of the Treasury Board promised improved experimental financial statements for the Spring of 1983. Testimony before your Committee now indicates that these experimental financial statements will not be ready until the Spring of 1984 or later. Your Committee is not satisfied with the rate of progress of this study.

(c) Presentation of Financial Statement Information

9. Your Committee is of the opinion that the Government's financial statements should report information in accordance with its essential nature and substance. Your Committee believes that the Government should select accounting policies that will permit information to be reported in this manner.

Recommendations

Your Committee recommends that:

(a) the Government give immediate consideration to such legislative amendments as are required to present the financial statements of the Government of Canada in such a manner that the Auditor General's reservations, as stated in his 1983 Report, would not be repeated in the future (Paragraph 7);

(b) the Comptroller General, in his continuing study of the purposes and objectives of the Government's financial statements, address the need for financial statements to report information in accordance with its essential nature and substance (Paragraph 9);

(c) the Comptroller General provide your Committee, not later than June 15, 1984, with experimental financial statements that will address the improvements sought in this Report (Paragraph 5); and

(d) the Comptroller General provide your Committee, as soon as possible, with a legal opinion on the latitude allowed to the Government in the use of Sections 54 and 55 of the Financial Administration Act.

11. Your Committee requests that the Government respond to the foregoing recommendations in accordance with Standing order 69(13).

12. A copy of the relevant Minutes of Proceedings and Evidence (*Issue No. 94 of the First Session of the Thirty-second Parliament and Issue No. 6 of the Second Session of the Thirty-second Parliament*) is tabled.

Respectfully submitted.

Doug Lewis
Chairman

REPORT TO THE HOUSE

Wednesday, April 11, 1984

The Standing Committee on Public Accounts has the honour to present its

SECOND REPORT

1. In accordance with its permanent Order of Reference contained in the Permanent and Provisional Standing Orders of the House of Commons, your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1983 and, in particular, Chapter 17, audit observations relating to the Department of Public Works (the Department).

2. The co-operation of the witnesses who appeared before your Committee is acknowledged and appreciated.

3. Your Committee wishes to comment on the following audit observations:

A – Paragraphs 17.54 to 17.56 – Failure to ensure fairness and economy in the spending of public funds in negotiating a lease agreement (the "Centennial towers" case); and

B – Paragraphs 17.66 to 17.69 – Contravention of Government Contracts Regulations.

A – Centennial Towers

4. Your Committee has the following concerns with respect to the Department's leasing of Centennial Towers:

(a) the Department failed to demonstrate an urgent need to lease the building;

(b) Treasury Board should not have approved the Department's submission in view of the questionable urgency of leasing the building;

(c) the Department failed to properly define the needs of and communicate with its client, the proposed Canada Security and Intelligence Service, before investigating available space;

(d) the Department arbitrarily selected Fisheries and Oceans, which was not a priority client, as an alternate tenant; and

(e) the Department was negligent in the manner in which it monitored the progress of the Security Agency Bill.

5. Your Committee heard testimony that the Department did not comply with Treasury Board directives in leasing Centennial Towers; its submission to Treasury Board was deficient and lacked key information. Although the Department justified, and Treasury Board accepted, the submission on the basis of an urgent need to house the headquarters of

the proposed Security Agency, your Committee heard no evidence of this urgency in testimony before it. Specifically, all interested parties, i.e. the Security Agency, the Department of Fisheries and Oceans, and Treasury Board itself, told your Committee that they were aware, at the time of Public Works' submission to Treasury Board, that Fisheries and Oceans was likely to be the prime tenant. However, Fisheries and Oceans testified that there was no urgency that their office space be consolidated in Centennial Towers. Your Committee feels that Treasury Board should not have approved the Department's submission and that the Department misrepresented the urgency of leasing this building as an expedient to obtain Treasury Board approval to fill the building. In so doing, the Department, in your Committee's view, failed to show due regard for economy in the expenditure of public funds.

6. Your Committee heard testimony that the Department did not adequately define the needs of its original client, the proposed Security Agency. For example, the Department negotiated with the owners of Centennial Towers prior to receiving details of the Security Agency's requirements. The Department also failed to ensure that Centennial Towers met the Agency's essential security and technical requirements and, as well, the Department failed to appreciate that the Security Agency did not require a downtown Ottawa location.

7. Your Committee heard testimony that the Department was under no obligation to make use of the authority granted by Treasury Board to lease Centennial Towers. In your Committee's view, the use of this authority to consolidate the offices of the Department of Fisheries and Oceans was unwarranted for the following reasons:

(a) the Department arbitrarily selected Fisheries and Oceans, which was not a priority client, as an alternate tenant;

(b) alternate space was available elsewhere for Fisheries and Oceans; and

(c) at no time did Fisheries and Oceans tell the Department that the consolidation of their office space was an urgent matter.

8. In view of the parliamentary and public debate surrounding the proposed Security Agency legislation, your Committee was astonished by the Department's testimony that it foresaw the passage of the bill to create the Agency by the Fall of 1983. Your Committee feels that more realistic monitory of the parliamentary process would have enabled the Department to follow more cost-effective procedures in its leasing of office accommodation.

9. As a result of the Department's leasing of Centennial Towers, the Government became committed to unproductive rental payments - estimated initially by the Auditor General to amount to $1 million per month. Members of your Committee toured the site and observed at first hand the Department's failure to make use of this building. At the date of this Report, your Committee in concerned that Centennial Towers remains largely unoccupied with the attendant cumulative cost to the taxpayer in non-productive rents.

B – *Contravention of Government Contracts Regulations*

10. Your Committee heard from Treasury Board that, since 1979, its regulations have required competitive bidding for construction-related engineering and architectural contracts above a certain threshold, which was initially set at $30,000 and revised in 1982 to $100,000. Treasury Board testified that these threshold levels were set through consultation with the industry and that other departments which engage consultants, such as Transport and Indian and Northern Affairs, follow the regulations and abide by the threshold.

11. Your Committee noted that the Department agreed with the Auditor General's findings that it contravened the Treasury Board threshold in 14 different cases.

12. Your Committee considers the Department's contravention of these regulations to be a very serious matter. The Department violated the regulations; it opened itself up to charges of favoritism; and it did not ensure the best value for the taxpayers dollar.

13. Your Committee heard testimony on the following corrective actions taken by the Department and Treasury Board:

(a) Treasury Board expressed its concern in writing to the Deputy Minister of the Department;

(b) in accordance with an internal directive dated May, 1983, the Department began to adhere to Treasury Board regulations regarding the mandatory tendering level;

(c) in all 14 cases where the regulations were broken the Department belatedly obtained Treasury Board approval before spending funds; and

(d) in some cases during the 1979 to 1983 period Treasury Board rejected the Department's submissions because the mandatory tendering requirement had not been met.

14. Your Committee feels that there was no excuse for the Department to repeatedly break Treasury Board regulations – 14 times in one year. If the Department disagreed with the regulations on mandatory tendering or sought an increase in the threshold level to $500,000, procedures existed for it to present its case to Treasury Board. Your Committee considers that, while rules are in place, they must be obeyed. Furthermore, your Committee is concerned that the Department took four years to comply with these regulations which all other departments appeared to have accepted from the outset. Your Committee seeks assurances that the Department will comply with these Treasury Board regulations in the future.

15. Your Committee concludes that Treasury Board should have enforced compliance with its regulations by not approving any of the Department's submissions in the 14 cases where the mandatory tendering threshold was exceeded. Your Committee calls upon Treasury Board to undertake such enforcement activity in the future.

Recommendations

16. Your Committee recommends that:

(a) the Department of Public Works continue to follow the directives and procedures for procuring office accommodation as laid down by the Treasury Board, and give the Public Accounts Committee that assurance in writing (Paragraphs 4 to 9);

(b) Treasury Board enforce compliance with its directives and procedures for dealing with deficient office accommodation submissions (Paragraph 4 to 9); and

(c) Treasury Board enforce compliance with its regulations for mandatory tendering by not approving any submissions where the threshold for mandatory tendering has not been observed (Paragraphs 10 to 15).

17. Your Committee requests that the Government respond to the foregoing recommendations in accordance with Standing Order 69(13).

18. A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 2, 3, 4 and 8 of the Second Session of the Thirty-second Parliament*) is tabled.

Respectfully submitted.

Doug Lewis
Chairman

REPORT TO THE HOUSE

Tuesday, May 8, 1984

The Standing Committee on Public Accounts has the honour to present its

THIRD REPORT

1. In accordance with its permanent Order of Reference contained in the Permanent and Provisional Standing Orders of the House of Commons, your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1983 and, in particular, Chapter 10 – The Comprehensive Audit of the Parks Canada Program of the Department of the Environment.

2. The Co-operation of the witnesses who appeared before your Committee is acknowledged and appreciated.

3. Your Committee heard testimony on the major issues arising from the comprehensive audit of Parks Canada, with emphasis on:

(a) managing new park acquisition and development; and

(b) cost recovery in the Banff and Jasper townsites.

Managing New Park Acquisition and Development

4. The Auditor General informed your Committee of his concern that Parks Canada had established a pattern of growth for the parks system without a well-developed capital plan and without providing sufficient information to the Government and Parliament on the total future cost implications for the program. Your Committee notes that Parks Canada recently submitted a draft long-term capital plan to Treasury Board. Your Committee wishes to be kept informed of Parks Canada's progress in finalizing and implementing this plan.

5. Notwithstanding Parks Canada's testimony regarding its progress towards a long-term capital plan, the Auditor General expressed a concern to your Committee that Parks Canada, in its development of existing new parks, had employed inadequate cost estimation procedures. Only Parks Canada's most recent submission to Cabinet for new park development, with regard to the Grasslands National Park in Saskatchewan, included estimating procedures that were satisfactory to the Auditor General. Although Parks Canada testified that the Grasslands model will be followed in the future, your Committee shares the Auditor General's concern that the more accurate cost estimation procedures followed in the Grasslands case be immediately applied to all other parks and historic sites presently under development.

6. Your Committee noted that Parks Canada did not make reference to the development of a long-term capital plan in its opening statement and that the Auditor General also made no such reference in the text of his comprehensive audit. In fact, the Auditor General testified that he had no knowledge at the time of his audit, that Parks Canada was working on such a plan nor had he subsequently seen a copy of the completed

plan. Since inadequate capital planning was a major criticism arising from the comprehensive audit, your Committee feels that it would have been good management practice for Parks Canada to have informed the Auditor General of this plan.

7. The Auditor General stated that he plans to follow-up Parks Canada's progress in implementing the recommendations arising out of his comprehensive audit. Your Committee is concerned that the Auditor General be in a position to report on his follow-up at the earliest opportunity.

Cost Recovery in the Banff and Jasper Townsites

8. Your Committee noted that, six years after the Cabinet directed them to do so, Parks Canada had still not resolved the outstanding issue of cost-recovery in the Banff and Jasper townsites. The Auditor General informed your Committee that Parks Canada had not set up a municipal accounting system and therefore was not in a position to know what costs should be recovered.

Operational Problems

9. Your Committee was concerned that Parks Canada did not demonstrate a sense of urgency in responding to important and long-standing operational problems in the national parks. For example, your Committee heard testimony that sewage and water systems were inadequate in the Banff, Riding Mountain, and Cape Breton Highlands national parks.

Recommendations

10. Your Committee recommends that:

(a) Parks Canada prepare a report for your Committee by October 31, 1984, on its progress in developing and implementing the long-term capital plan, in resolving the problems of the Banff and Jasper townsites, and in responding to all other recommendations of the Auditor General (Paragraphs 4, 5 and 8); and

(b) Parks Canada consult with the Auditor General in the review and assessment of all major initiatives taken in relation to the findings of his comprehensive audit (Paragraph 6).

11. Your Committee requests that the Government respond to the foregoing recommendations in accordance with Standing Order 69(13).

12. A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 6, 7 and 10 of the Second Session of the Thirty-second Parliament*) is tabled.

Respectfully submitted.

Doug Lewis
Chairman

REPORT TO THE HOUSE

Wednesday, June 13, 1984

The Standing Committee on Public Accounts has the honour to present its

FOURTH REPORT

Notwithstanding the terms of the Order of Reference dated Thursday, December 3, 1981, your Committee recommends that the said Order of Reference be changed to read as follows:

That during the Thirty-second Parliament, 3 Members to be appointed by the Chairman, and the Clerk or a Committee Research Officer of the Standing Committee on Public Accounts, attend the annual meetings of the Canadian Council of Public Accounts Committees and the Canadian Comprehensive Auditing Foundation, commencing in 1981, and that the appropriate costs, including living and travel expenses be paid.

A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 11 and 14 which includes this report*) is tabled.

(Concurred in: June 20, 1984)

REPORT TO THE HOUSE

Wednesday, June 13, 1984

The Standing Committee on Public Accounts has the honour to present its

FIFTH REPORT

1. In accordance with its permanent Order of Reference contained in the Permanent and Provisional Standing Orders of the House of Commons, your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1983 and, in particular, Chapter 18 and paragraphs 18.29-18.31 – Reporting Responsibilities.

2. Your Committee considered the reporting practices of the Auditor General and, in particular, the timeliness of his annual report to the House of Commons. Your Committee notes that, under the present Auditor General Act, the Auditor General normally may report only annually to the House of Commons. Your Committee favours the reporting of comprehensive and other audits on a completion-date basis. This will enable your Committee to deal with the Auditor General's findings in a timely manner and to exert its remedial influence as soon as possible after the audit is completed. The Auditor General endorses this approach because it provides for greater efficiency and flexibility in his reporting to Parliament.

3. Your Committee therefore recommends that the Government give immediate consideration to amending the Auditor General Act, as follows (new wording underlined):

"7. (1) The Auditor General shall report at least annually to the House of Commons

(a) on the work of his office; and

(b) on whether, in carrying on the work of his office, he received all the information and explanations he required.

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before the 31st day of December in the year to which the annual report relates and the Speaker of the House of Commons shall lay each annual and other report under Sub-section (1) before the House of Commons forthwith after receipt thereof by him or, if that House is not sitting, on the first day next thereafter that the House of Commons is sitting.

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in his opinion, should be reported immediately."

4. Your Committee requests that the government respond to the foregoing recommendations in accordance with Standing Order 69(13).

5. A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 11 and 14 which includes this report*) is tabled.

Respectfully submitted.

Doug Lewis,
Chairman

REPORT TO THE HOUSE

Wednesday, June 13, 1984

The Standing Committee on Public Accounts has the honour to present its

SIXTH REPORT

1. In accordance with its permanent Order of Reference contained in the Permanent and Provisional Standing Orders of the House of Commons, your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1983 and, in particular, Chapter 17, paragraphs 17.49 to 17.53, ITC/DREE (the Department) – Negligence in the payment of a loan guarantee.

2. The testimony of the witnesses who appeared before your Committee and, in particular, Mr. Henry Rhude, Chairman and Chief Executive Officer of Central Trust, is acknowledged and appreciated.

3. Your Committee heard testimony on the circumstances surrounding the Department's payment of a claim under loan guarantee agreements between the Crown and Central Trust Company. The guaranteed loans were for the completion of a motel facility in Tracadie, New Brunswick (the "Riviera Motel").

4. In March, 1982, after several defaults in payment, Central Trust exercised a power of sale to realize on its security. The motel and contents were sold for a total consideration of $200 at a public auction. Only one bid was received. Central Trust requested payment under the loan guarantees and then the Department paid the guaranteed amount of $315,000 to Central Trust, despite major deficiencies in the liquidation procedures.

5. In this report, your Committee will deal with the failings of the Department, the involvement of Central Trust and certain conclusions which arise from the events of this case.

FAILINGS OF THE DEPARTMENT

6. Your Committee wishes to comment on the following major failings of the Department:

(a) inadequate monitoring of Central Trust;

(b) inadequate case review procedures within the Department;

(c) inadequate legal advice;

(d) senior management's failure to uncover this case until it was brought to their attention by the Auditor General;

(e) the delay in launching a civil suit against the lender; and

(f) the passive behaviour of the public servants involved.

(a) Inadequate Monitoring

7. Your Committee heard testimony that called into question the adequacy of the Department's monitoring under the loan guarantee agreements with Central Trust. Central Trust did not abide by the terms of the agreements but was not held to account. Although notified two months ahead of time that Central Trust planned to proceed by public auction, which was contrary to the agreements, the Department did not communicate with Central Trust in writing until after the auction had taken place. As the Department admitted to your Committee, no effort was made to insist that Central Trust adhere to the agreements.

(b) Inadequate Departmental Procedures

8. Your Committee was astonished by the deficiencies in the Department's procedures revealed by the events of this case. The Department testified that the individual managing the account failed to understand the implications of Central Trust's actions. When this happened, the procedures for review by senior officers or legal counsel proved to be completely inadequate. No one in the Department took any action to protect the Crown's interests before or after the public auction. Before the auction, the Department's resources were not called upon to appraise the property or ensure that a protective bid was placed. After the auction, an official at the director-general level was able to authorize payment of Central Trust's claim without informing senior management or conducting an investigation of the particulars of the case.

(c) Inadequate Legal Advice

9. In its testimony, the Department openly admitted to the inadequacies of the legal advice provided in this case. Your Committee cannot comprehend how any competent lawyer could provide advice of the nature that the Department received. For example, the Department's counsel advised that the fact that the lender proceeded by public auction rather than by public tender was of little consequence. Counsel apparently failed to understand that this represented a violation of the agreements between the lender and the Crown.

10. Your Committee also noted that the Department did not attempt to obtain a second legal opinion from the private sector. Your Committee expects the Department to ensure that the necessary procedures are established to obtain second opinions from law firms in the private sector in cases of this nature.

(d) Senior Management's Failure to Uncover the Case

11. The Department acknowledged that it was the Auditor General who brought this case to the attention of senior management, roughly one year after the payment of the claim. This failure on the part of senior management leads your Committee to call into question the effectiveness of both the comptroller's and internal audit sections of the Department.

(e) The Delay in Launching a Civil Suit

12. The Department testified that it delayed any civil action against Central Trust until the results of an RCMP criminal investigation, also requested by the Department, were known. Your Committee is of the opinion that a civil action could have been initiated at the same time.

(f) Passive Behaviour of Public Servants

13. This case illustrates to your Committee a general problem within the public service; the need to ensure that officials at all levels are seized of their responsibilities and are action-oriented, rather than passive. When responsible public servants are faced with exceptional circumstances, such as, in the Riviera Motel case, a financial institution's failure to abide by agreements with the Crown, they should be motivated to alert senior management and explore every avenue to protect the Crown's interests.

INVOLVEMENT OF CENTRAL TRUST

14. Central Trust testified that it relied upon the guarantees of the federal government for repayment of the loans to the Riviera Motel. Although Central Trust sought, and followed, the Department's advice, it did not fully comply with the terms of the loan guarantee agreements. Your Committee is of the opinion that prudent management would have dictated strict compliance with the guarantees.

CONCLUSIONS OF THE COMMITTEE

15. Your Committee noted that on March 10, 1982, one day after the public auction:

(a) Central Trust Company officers executed a deed for the motel property to La Caisse Populaire de Tracadie Limitée, for the sum of $200;

(b) La Caisse Populaire de Tracadie Limitée executed a deed for the motel property to Tony's Bar-B-Que Limitée for $75,200; and

(c) Tony's Bar-B-Que Limitée executed a mortgage and debenture to Standard Investments Limited for $175,000.

Given the unsuccessful nature of the investment, the amount of money involved, the negotiation and legal work normally required, and the complicated nature of the investment, your Committee concludes that the above-cited transactions could not have been completed the day after the public auction unless the parties involved had prior knowledge that the Department would honour the guarantees and that no other party would bid at the public auction.

16. Your Committee noted that La Gestion Bellefeuille Inc., a non-profit organization, entered into an option agreement and then proceeded to buy the motel property for $600,000 with a mortgage back to Tony's Bar-B-Que Limitée of $225,707.75 on October 17, 1983. Your Committee is concerned by the apparent increase in the value of the

property and asks the Government to assure itself that no further public monies are advanced without adequate protection of the taxpayers' interests.

RECOMMENDATIONS

17. Your Committee recommends that:

(a) The Department develop and report to the Auditor General, by September 30, 1984, detailed corrective measures to rectify the inadequacies noted by your Committee in paragraphs 6 to 13 above; and

(b) The Auditor General assess the aforementioned report of the Department and report his findings to your Committee by October 31, 1984.

18. A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 12, 13, 14 and 15 which includes this report*) is tabled.

Respectfully submitted.

Doug Lewis
Chairman